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Message from the Commissioner

The U.S. Customs Service has established a Risk Management Process to best allocate available resources to our priorities. This booklet describes the Risk Management Process for trade compliance now being used by the U.S. Customs Service.

The latest trade statistics indicate that imports will continue to increase. This greater volume combined with increased trade complexity makes our deployment of resources vitally important. In 1993, the Customs Modernization Act enabled Customs to streamline its processes and take advantage of new information technologies. Throughout Customs, employees are identifying and assessing potential compliance problems. As a result, we have already begun to focus on areas where compliance initiatives can have the greatest impact. The Customs Service is monitoring the importing activities of the largest companies. We have also targeted eight primary focus industries and twelve priority trade issues for intensive oversight, as described in detail within this booklet.

Through the Customs Risk Management Process, we are constantly analyzing information to determine what merits attention. Customs now consciously dedicates more resources to some areas and less to others. Whether an importer's cargo is inspected at the port, or supporting documentation is reviewed afterwards, all findings of compliance as well as violations are recorded and analyzed within the Risk Management Process. This process segregates the significant violations and focuses resources on the most serious problems. For the first time, Customs can systematically lessen its oversight of compliant companies and dedicate more resources to non-compliant companies.

This information is provided to give the public insight into Customs operating procedures for monitoring trade compliance. By setting forth our priorities and our process for managing those priorities, we challenge all importing entities to establish procedures or evaluate existing procedures for trade compliance.

Raymond W. Kelly Commissioner, U.S. Customs Service

Introduction

Risk is a part of daily life. There is uncertainty in almost all aspects of day-to-day living. Managing these risks is a natural reaction to minimize the level of potential harm that comes with not knowing what the future might hold. Deciding that it is a good idea to carry an umbrella because the forecast calls for rain is a perfect reaction to minimize the possibility of getting wet. Risk management then becomes those methods that are used to reduce uncertainty and to change behavior and actions accordingly.

Over the past few years a growing body of knowledge has developed in the United States Customs Service(Customs), in the area of risk management and the development of a systematic approach to responding to the ever changing nature of risk. With limited resources and dynamic growth in trade there was a realization that there were better ways to address potential risk in commercial trade transactions. For Customs, risk is defined as the degree of exposure to the chance of noncompliance which could result in loss or injury to trade, industry, or the public.

This document addresses some of the latest developments in risk management in the area of commercial trade. It is designed to be shared with individuals and organizations that are familiar with the concept of risk management in general, but not with the specifics of the system in use by Customs.

A CUSTOMS STORY

In 1998, Customs Port Director Susan Parker was facing serious workload and resource problems. Imports into her port had increased 15 percent since 1996, but resources remained the same. At the same time, she had a part to play in achieving the Customs primary Trade Compliance Process goal of raising the level of compliance of goods entering the commerce of the United States. Port Director Parker had to confront the challenge presented to customs organizations around the world: how to identify imports posing the highest risk so that she could dedicate her resources to areas that presented the greatest risk of non-compliance.

Her first step was to collect data. She looked at imports entering through her port and how they related to Customs' national priorities. One of the major imports was automobile parts, one of eight primary focus industries for the United States. Customs established a national compliance goal for the automobile parts industry to achieve a compliance rate of 89 percent by 1998. The compliance rate for this industry within Port Director Parker's port was 82 percent. Clearly, this was an area requiring additional focus.

Automobile parts is an enormous industry, far too large to take on in one single effort. Her next step was to analyze the data she had collected to pinpoint specific areas of risk. Much information was already available from national Compliance Measurement and Compliance Assessment data. In addition, she conducted a local measurement to help narrow her focus. Using a variety of automated tools available to identify trends in the raw data, her staff at the port were able to provide some key information:

Kyoto Convention – General Annex – Chapter 6
Guidelines on Customs Control

- Harmonized Tariff Schedule number (HTS) 8708, a broad classification for automobile parts, represented the greatest percentage of auto parts imports within the port.
- Importations under HTS 8708 at the port were only 76 percent compliant, lower than the port average for the industry as a whole.
- 12 importers and 3 brokers accounted for 84 percent of all HTS 8708 imports.
- Compliance Assessments were complete for three of those importers, and they were highly compliant with good internal control systems.
- A look at national trends revealed that the most serious problem nationally for HTS 8708 was failure to pay anti-dumping duties.

Using the Trend Analysis and Analytical Selectivity Program (TAP), Port Director Parker also discovered that one of the importers shipped equally into two different ports. However, all HTS 8708 imports came through her port. Coordination with Ron Jones, Port Director of the second port, revealed two important facts: first, that Port Director Jones' port had provided the importer with a Headquarters' ruling that its HTS 8708 goods were subject to anti-dumping duties; and second, that shortly after receiving that ruling, the importer shifted all 8708 imports to Port Director Parker's port.

With that information, Port Director Parker was ready to prescribe action. She notified the Office of Investigations and they initiated a \$164 million fraud case. To preclude any possibility of further "port-shopping", her port's Enforcement Evaluation Team ensured that national criteria were entered regarding 8708 imports for this company. She then had port personnel research other companies importing similar merchandise from the same manufacturers. A second, unrelated company soon submitted a tender of \$654,000. To ensure that the prescribed action was effective, she established a tracking protocol. In two months, her Enforcement Evaluation Team will revisit the specific fraud case for the first importer, and determine if additional action is required with other importers.

While this case study is simple, its results are real. Similar efforts to apply the techniques of Risk Management and data analysis throughout the U.S. Customs Service have revealed:

- Failure to pay duty on freight charges in the steel industry — Informed compliance efforts resulted in collection of \$1.5 million in additional duties and \$2.5 million in additional anti-dumping duties.
- Confusion over the classification of screws and bolts — Interventions in this area resulted in a revenue recovery of \$3.2 million.
- Serious problems with textile transshipment through Country A — Cooperative efforts with the Country's Ministry of Trade resulted in 64 transshipment convictions and 15 export license suspensions.

And this is just the beginning. How the U.S. Customs Service applies a comprehensive Risk Management Process to achieve these results is the purpose of this publication.

UNITED STATES CUSTOMS SERVICE

The United States Customs Service mission is diverse. As an agency within the Department of the Treasury, its original mission in 1789 to collect and protect the revenue of the United States has expanded significantly to encompass enforcement of all trade import laws, narcotics interdiction, passenger enforcement, and export enforcement. The strategic intent of Customs today is to protect the public against violations which threaten the national economy and health and safety through targeted enforcement and informed compliance, and to be the national resource for information on goods and people crossing our borders.

With approximately 20,000 personnel located at more than 300 ports of entry, Customs has reorganized to establish a system of focused enforcement utilizing methodologies geared to maximizing port effectiveness and integrating core operational processes. One of the core processes for Customs is Trade Compliance. This includes every activity related to trade from pre-importation analysis through cargo arrival, examination, release, investigation, revenue collection, liquidation, and archiving of trade data.

In 1997, Customs processed more than \$845 billion in import transactions. This represents more than a 100 percent growth over 10 years, while resources remained relatively static (approximately 4,500 employees dedicated to trade compliance). For the next 5 years, all indicators point to continued growth. In addition, new trade agreements and increased trade complexity associated with this greater volume make for a rapidly changing environment.

To confront these changes, Customs established a Trade Compliance Process Owner and Board of Directors, responsible for all trade policy and implementation. In 1995, the Board initiated a complete redesign of the Trade Compliance Process which included: changing the focus from transactions to accounts; Primary Focus Industries; Compliance Measurement and Assessment; and development of the Automated Commercial Environment (ACE) to support the redesigned process. The Fiscal Year 2004 goals of this new process are to:

- Achieve 90 percent overall trade compliance.
- Achieve 95 percent compliance in primary focus industries.
- Maintain collection of at least 99 percent of the revenue.
- Reduce cargo release cycle time for compliant imports.
- Increase customer satisfaction.
- Reduce cost per transaction

To achieve these goals, Customs must strengthen the analytical capabilities of its employees to maximize compliance and proactively enforce critical areas. To use our limited resources in the most effective way possible, Customs must better focus its resources towards areas with the highest risk for significant trade violation.

This is the genesis of the U.S. Customs Service Risk Management Process for trade.

U.S. CUSTOMS RISK MANAGEMENT OVERVIEW

Worldwide, customs services are now asking: Do we want to use our finite resources to perform limited reviews on 100 percent of imports, or would it be more effective to perform extensive, thorough reviews on a smaller percentage of imports? Do we assume that all importers, and therefore all importations, are somehow deficient and result in a loss of revenue or present a threat to the government and public? Or, do we accept, based on our own experiences, that some importers and some imports present a much more significant risk than others?

The key word here is risk. Customs administrations must focus on what presents the greatest risk of loss to the government and public. Customs has accepted the fact that many importers have a record of complying with import laws and do not present a risk that justifies a significant allocation of resources. This logic leads to performing a risk analysis or risk assessment to determine who and what merits attention.

Risk increases with lack of knowledge. The purpose of risk management is to close the gap between the known and unknown.

Risk is characterized by the fact that:

- It is partially unknown — if we were 100 percent sure of the compliance or non-compliance of every shipment, Customs job would be easy
- It changes with time — as trade laws, importers, and industries change
- It is manageable — Customs can confront and take action on non-compliance.

Risk management is a method of managing that concentrates on identifying and controlling events that have the potential to cause significant problems. In Customs trade terms, that means identifying those imports that represent the greatest risk of non-compliance so that we can focus our resources in those areas.

The U.S. Customs Risk Management Process for trade consists of four key steps:

1. Collect Data and Information
2. Analyze and Assess Risk
3. Prescribe Action
4. Track and Report

Established programs such as Account Management, Compliance Measurement, Compliance Assessment, and Enforcement Evaluation Teams are critical components of Customs risk management. However, to be most effective, Customs Risk Management Process must be formal, systematic, and applied in a disciplined manner. Each person involved in the importation of goods into the commerce of the United States is part of the Customs Risk Management Process.

Collect Data and Information (Step 1)

Proper risk management requires a systematic approach to collecting data.

The following questions should be answered in this step: Are collection methods statistically valid? Are there negative trends or forecasts? What can we learn from past experience? Risks cannot be assessed or managed until data is collected and the risks can be identified and described.

The key to risk management is to systematically isolate risk identified throughout the Trade Compliance Process. Customs' primary tools in this area are Compliance Measurement, Compliance Assessment, Account Management, criteria-driven examinations and document reviews. In our case study, the port accomplished this step by compiling national Compliance Measurement and Compliance Assessment data, comparing its performance with national trends and goals, and conducting a local measurement.

Analyze and Assess Risk (Step 2)

The next step is to analyze the data and determine the likelihood of non-compliance.

Customs knows that the vast majority of imports entering the country are compliant (81 percent in 1997). Customs also knows the compliance rate for various industries, specific commodities, and certain importers. Analyzing these historical data and trends, and applying definitions of significance and materiality, allow Customs to narrow its focus on two areas of the greatest potential risk.

The key components of Customs' risk analysis and assessment are: Employee specialization of knowledge and experience, Compliance Risk Categories, Enforce Impact Levels, Compliance Measurement Significance Definitions, and Compliance Assessment Materiality. Customs has also developed a complete set of sophisticated automated tools such as Customs Automated Port Profile System (CAPPS), the Trend Analysis and Analytical Selectivity Program (TAP), and the Account Activity Tool (AAT). The port in the case study used these tools and collaborated with other ports to identify a serious risk in the area of anti-dumping duties for HTS 8708.

Prescribe Action (Step 3)

Once a potential risk has been identified and analyzed, it is time to design the appropriate action and dedicate necessary resources.

This step requires two distinct actions: (1) identifying the cause of the risk, such as an importer's lack of knowledge, complex trade laws, or willful disregard for importer laws; and (2) designing an action and assigning resources to address that risk.

Involvement of skilled personnel and managers that control the resources is crucial here. A wide selection of tools that can address specific causes of non-compliance is also advantageous. The primary components of this step are informed compliance and enforced compliance. In our case study, Customs was able to determine that willful disregard for Customs laws was a root cause of non-compliance for one importer. The port and the Office of Investigations assigned investigative and examination resources to address the immediate problem, and additional import specialist resources to identify similar violations.

Track and Report (Step 4)

Once the appropriate action is designed, ownership for that action must be assigned and its results must be tracked and fed back into the Risk Management Process. Ensuring that actions are implemented and reporting their results are critical to the cycle of identifying and eliminating future risk.

In Customs, Enforcement Evaluation Teams (EET's), the Strategic Planning Board (SPB), Compliance Assessment Teams and Account Managers ensure that responsibility is assigned and accepted for all actions. EET's and the SPB meet regularly to track the progress of local and national actions. Compliance Assessment Teams conduct follow-up verifications with companies to ensure Compliance Improvement Plans were effectively implemented, and Account Managers meet regularly with their accounts to ensure implementation of Account Action Plans and track compliance progress.

In our case study, the Office of Investigations took responsibility for the fraud case, and the port ensured national criteria were input to prevent future "port-shopping." The Enforcement Evaluation Team also followed up to track the progress of the case and research additional evidence of non-compliance.

Continuous Risk Management

As stated previously, to be most effective, Customs Risk Management Process must be formal, systematic, and applied in a disciplined manner. Since risk is never absolutely known, and because risk can change over time, results and experience must be fed back into the process to narrow the knowledge gap and better predict future risk.

TIME LINE

Looking at all of the elements of Customs' Risk Management Process at the same time can be overwhelming. The major components are integrated into every aspect of the Trade Compliance Process. However, Customs did not begin with this level of integration and complexity. No agency could. The Risk Management Process for Customs started out quite small in 1993 and at that time was not even identified as a risk management program. The following time line is an illustration of how the Customs program evolved from a small, targeted measurement effort into an integrated Risk Management Process.

1789-1960's

- Customs attempted to examine every imported shipment, but began to be concerned about projected increases in trade.

1970's

- Customs moved toward automation, developing several independent automated systems.

1983

- The Automated Commercial System (ACS), an integrated automated entry processing and release system, was introduced. As workloads continued to increase, Customs employed a national selectivity system to help identify only certain shipments for examination.

1988

- Customs' automated environment began allowing for paperless release of cargo.

1993

- The Customs Modernization Act allowed a much-needed update of import regulations and enabled Customs to streamline its processes and take advantage of new information technologies.
- In 1993, the Office of Selectivity Redesign was created. This small office reported to the Commissioner, and its purpose was to redesign how Customs identified imports for more intensive review.

1994

- For the first time, a statistical sampling methodology was used to identify shipments for exam in every port and obtain a statistically valid compliance rate.
- A Trade Compliance Process Owner and Board of Directors were established to redesign the entire Trade Compliance Process and direct all related policy. The Board set the first strategic goals for the process.

1995

- Compliance Measurement expanded to all commodities in all ports and for the first time, Customs had a national baseline measurement for compliance.
- The Compliance Assessment program was initiated.
- Under the guidance of the Board of Directors, a national team began to design the account management process.
- Customs reorganized the entire agency and created the Office of Strategic Trade (OST). Its mission is to maximize trade compliance by establishing strategic plans that focus and direct Customs actions.

1996

- Primary Focus Industries — industries vital to our national interests — were identified, and through Compliance Measurement, compliance rates for each industry were established.
- Account Management was initiated through a prototype with eight importers.
- Ports began to use Compliance Measurement data to assess local risk and assign resources accordingly.

1997

- The Integrated Trade Measurement System was established, linking the two key programs of Compliance Measurement and Compliance Assessment, allowing Customs to further focus its resources on non-compliance.
- Account Management moved out of the test phase. Full-time Account Manager positions were created, and ports began testing the Account Management concept locally.
- Account-based measurement was incorporated into the Compliance Measurement program.

1998

- The first release of the Automated Commercial Environment (ACE), a replacement of the ACS system designed in the 1980's, was introduced.
- Account Management expanded to 145 accounts managed by full-time Account Managers and 250 accounts managed by teams in the ports, representing 30 percent of the value and 38 percent of the volume of all imports.
- Establishment of Enforcement Evaluation Teams began.
- The Importer Compliance Monitoring Program – a Customs-directed approach for importers to assess their own systems and compliance - was prototyped.
- National programs such as the Multi-Port Approach to Raise Compliance (MARC 2000) and the Company Enforced Compliance Process used a risk management approach to identify key areas of compliance concern and direct national resources to those areas.
- Customs created a Risk Management Team at Headquarters, devoted full-time to identifying, managing, and alleviating risks associated with the Trade Compliance Process.

Building the Foundation

As part of the Risk Management Process, Customs' management made several overarching decisions about the focus and direction of the Trade Compliance Process. Basically, they defined priorities for Customs' trade process. While quantitative data was used as a foundation for the decisions, issues such as new trade laws, economic impact and available resources were also considered. By making these overarching corporate decisions Customs was able to take significant steps forward in focusing its work.

The core of Customs Risk Management Process includes Primary Focus Industries, Trade Priority Issues, Account Management, and the Integrated Trade Measurement System including sampling plans and significance and materiality definitions. Customs' Strategic and Annual Plan and the Trade Compliance and Enforcement Plan capture these elements and define the work for the agency for the coming year.

BACKGROUND

Historically, the principle duties performed by the Customs Service have focused on the collection of revenue, the control of cargo, and the enforcement of trade laws and regulations. Customs has been a front-line, law enforcement, revenue-producing agency for more than 200 years.

For much of our history resources kept pace with work-load and all processing was manual and transaction oriented. In the 1960's, Customs became concerned about projected increases in trade. In the 1970's, emergence in technology enabled a move toward automation of basic processes. A number of independent automated systems were developed, but it was not until 1983 that Customs had an integrated Automated Commercial System (ACS).

As workloads increased, Customs reassessed its traditional work processing methodologies. Automation allowed Customs to reduce paperwork and document handling and to streamline operations. However, gains in processing were soon offset by continued growth and increasing trade complexity.

The passage of the Customs Modernization Act, commonly called the “Mod Act”, in December 1993, provided the stimulus for change in all Customs trade-related activities. Central to the Mod Act is the concept that Customs shares responsibility with the importing community for achieving maximum compliance of U.S. trade laws and regulations. Similarly, importers must demonstrate reasonable care to comply with such laws. This changed relationship coupled with provisions allowing electronic submissions of data has enabled Customs to take advantage of new information technologies and to further streamline processes.

Through the mid-1990’s, Customs managed its imports entirely on a transaction basis. As each entry was presented to Customs for release, Customs made the decision to examine the goods, request additional information, or release the goods. To help make these decisions, information about the transaction was run against criteria such as country of origin, tariff, and importer name. However, inspectors and import specialists could not easily obtain trends about a company’s importing history. If a violation was detected, it was handled on a case-by-case basis. There was no organized way to address ongoing compliance problems nationally.

Two key factors moved Customs to account-based management: rapidly increasing workload and ever-improving technological capabilities. In 1993, nearly 292,000 companies imported goods into the United States with a value of \$575 billion. In just four years, the number had increased to more than 400,000 companies and imports valued at \$845 billion. During that same period, Customs trade compliance resources remained static. In addition, technological developments now allow Customs to create a basic importer profile in just a few hours. Previously, this same profile took months.

Customs analyzed its workload and discovered the top 100 importers represented 33 percent of the value of all goods imported into the United States. Currently, the top 1000 importers represent 60 percent of the value, and the top 7,880 importers (all those importing more than \$10 million) represent 81 percent of the value. Focusing resources on the largest importers, Customs can more significantly impact compliance.

PRIMARY FOCUS INDUSTRIES

In addition to identifying the largest importers, Customs needed to further prioritize and organize its workload. A major innovation was the identification of Primary Focus Industries (PFI’s) — industries vital to our national interests that are directly impacted by the level of importer compliance with trade laws. The critical industries are:

- Agricultural Products
- Automobiles and Automobile Parts
- Communications
- Critical Components (Bearings and Fasteners)
- Footwear
- Production and Manufacturing Equipment (Capital)
- Steel
- Textiles and Wearing Apparel

The PFI's were determined by a number of factors including: strategic importance, international trade agreement concerns (including NAFTA, quotas, etc.), duty, public health and safety, Intellectual Property Rights (IPR), and Gross Domestic Product/economic impact. Setting priorities means that Customs consciously devote more resources to some areas and less to others.

These commodity areas attract significant attention from Customs in every regard: informed compliance, enforced compliance, Compliance Measurement, Compliance Assessment, interventions, etc. By establishing a national focus on these product sectors, they receive the level of attention, which they warrant.

There is also a "watch list" for emerging industry groups such as chemicals, pharmaceuticals, and petroleum products, which, although not as highly scrutinized as the eight PFI's, are analyzed as possible future PFI's.

TRADE PRIORITY ISSUES

Because not all important trade issues confronting Customs can be identified by industry sectors, additional trade priorities were identified. Attention to these trade issues ensures that the full ranges of Customs responsibilities are covered in a measured manner and are responsive to genuine resource constraints.

The twelve priority issues are:

- Classification
- Transshipment
- Trade Statistics
- Trade Agreements
- Country of Origin Marking
- Quota Evasion
- Embargoes and Sanctions
- Revenue
- Intellectual Property Rights
- Valuation
- Public Health and Safety
- Anti-Dumping and Countervailing Duties

Clearly, many of these issues overlap a range of products or source countries. Others link closely with the primary focus industries — textiles with quotas and transshipment, for instance. A few issues such as embargoes and forced labor are country-specific.

ACCOUNT MANAGEMENT

Account Management, Customs' approach to managing its work through accounts rather than individual transactions, is the central focus of the Trade Compliance Process. It weaves its way throughout the entire Risk Management Process. Details on the account management process are found in almost every step.

An account is defined as any entity with which Customs has an interest related to trade compliance. In the future, Customs may work with many types of accounts: importers, brokers, carriers, couriers, etc. Today, however, Customs' focus is on importer accounts.

Accounts are managed by full-time Account Managers or Port Account Teams. Customs selects accounts based upon an importer's volume, value, percent of PFI imports, and past compliance. Account Managers and Port Account Teams follow a series of steps to analyze an account's performance, coordinate an account's activities, identify trade compliance problems, and work with the account to resolve those problems.

INTEGRATED TRADE MEASUREMENT SYSTEM

In 1997, Customs data collection approaches were linked together to form the Integrated Trade Measurement System. This system consists of Compliance Measurement (CM), the measurement of individual transactions, and Compliance Assessment (CA), the post-transaction measurement of the compliance of an account. This system is presented in greater detail in the "Collect Data and Information" and "Analyze and Assess Risk" sections. However, certain key management decisions directed the evolution of the system.

Compliance Measurement Sampling Plan

Out of the millions of shipments entering the United States, a statistically valid sample is selected for a measurement of compliance with U.S. trade laws and regulations. This statistical sample is derived from a CM Sampling Plan that uses calculated scores to provide a statistically valid, scientific measure.

The current risk scoring system uses four factors: total volume, total value, average line value, and previous year's compliance rates. These factors, analyzed together, create a relative index, or risk score, used to determine the level of resource allocation in examination.

Compliance Measurement Significance Definitions

In 1998, Customs also defined "significance" for import transaction violations. This represented a higher level of sophistication in our systems to acknowledge that every discrepancy or instance of non-compliance was not of equal importance to Customs. All violations are captured and recorded. However, analysis of the significance of those violations guides our assessment of risk. Additional details on this subject are included in the "Analyze and Assess Risk" section.

Compliance Assessment Review

As with CM, CA uses a statistical approach to sample accounts imports and assesses the account's level of compliance. Details on this sampling plan are included in the Appendix. However, before any sampling begins, Customs must first identify which accounts will undergo a CA.

The process for selecting assessment candidates takes into consideration the PFI's and "watch list" areas and key importers within those industries. Each year, the universe of the top 1,000 importers and the top 250 importers in each PFI are defined. These universes are examined and candidates are selected using a variety of evaluation information such as CM data, PFI involvement, value of importation's, trade priority issues, and industry trends.

Compliance Assessment Materiality

As with CM, the significance or "materiality" of discrepancies discovered during a CA is also considered. The purpose is to provide consistent treatment of errors found and provide perspective to the seriousness of the compliance problems discovered. More detail on this is provided in the "Analyze and Assess Risk" section and in the Appendix.

TRADE COMPLIANCE ENFORCEMENT PLAN

Customs Trade Compliance and Enforcement Plan (TCEP) identifies the work the agency will under-take to achieve the goals of the Trade Compliance Process. It is linked directly to the agency's Five-year Strategic Plan and outlines the body of nationally directed trade compliance work for the year. Ports then develop local TCEP's to support the national plan.

Key elements of the plan include:

- Annual goals and objectives
- Overview of compliance results to date
- List of primary focus industries and trade priority issues
- National subplans for the industries
- Compliance Measurement plan for the year
- Compliance Assessment plan for the year
- Investigative and enforcement actions
- Specific targets for nationally-directed programs such as Account Management, automation, and implementation of trade agreements

Collect Data & Information – Step 1

The collection of data and information related to the Trade Compliance Process is the first step in the Customs Risk Management Process. Through the collection of data, we can begin to identify which importers are most likely to be non-compliant and the probable nature of their non-compliance. Proper use of this knowledge will assist in effectively deploying our resources. Through this collection, Customs is able to establish baselines, comprehend its universe of trade importations and maintain a historical perspective of trade patterns. In this first step, Customs is attempting to identify any potential risk in the Trade Compliance Process. The key to risk identification is to systematically review the entire process. The following questions can be answered: Are there changes in performance? Negative trends or forecasts? Lessons learned from past experience? Risks cannot be assessed or managed until they are identified and described in an understandable way. Customs has several mechanisms in place to identify risks in the importation of trade.

- Integrated Trade Measurement System
 - Compliance Measurement
 - Compliance Assessment
- National Criteria
- Account Management

INTEGRATED TRADE MEASUREMENT SYSTEM

Since 1995, components of the Integrated Trade Measurement System have measured the compliance level of international trade entering the commerce of the United States. The measurement program identifies both low and high-risk shipments entering the commerce of the United States. This measurement covers the entire Harmonized Tariff Schedule (HTS), running for each fiscal year. Fiscal Year (FY) 1998 is the fourth year of measuring all importations entering the commerce of the United States through every port.

There are two components to the Integrated Trade Measurement System: Compliance Measurement and Compliance Assessment. CM measures the compliance of individual transactions based on actual cargo inspections and port reviews of documentation. The results provide tariff-based compliance rates which are applied to industries and, when the sample size is sufficient, to individual importers (accounts). CA also uses a statistical methodology to assess an importing company's systems, evaluating business procedures in an audit-like environment. This post-transaction review allows Customs to make a more precise determination of risk at the company level. The two processes, CA and CM, together enable Customs to identify problems and make a specific evaluation of the risk of non-compliance posed by an individual company and the industry over-all. Once a level of risk is identified, Customs can select the appropriate response to the risk.

Integrating Compliance Assessment and Compliance Measurement

In FY 1997, Compliance Assessment was integrated into Compliance Measurement, after their initial development as separate systems. By identifying highly compliant, high volume national accounts through CA, Customs focuses resources on non-compliant entities. By concentrating resources on non-compliant entities, Customs obtains critical information on non-compliance. Each year the integrated system is updated with CA and CM data on potential non-compliance, allowing Customs to allocate resources in those areas. Accounts

which are highly compliant, with reasonable care systems, are sampled via port transactions at the minimum level to provide corroboration of their continued compliance. Accounts which are compliant but have system concerns are sampled at a slightly higher level to monitor the impact of their system. A non-compliant account receives a higher level of sampling providing a statistically valid indication of acceptable compliance and (unlike compliant accounts) is subject to national criteria and local initiatives related to its imports. A key element in the effectiveness of the CM/CA integration is the continued refinement of the Customs sampling formula. From the first “risk score” employed in FY 95, Customs has developed more objective and data-driven refinements. The integration of CA results has greatly enhanced the outcome probability of the formula. In FY 98, the formula provides the maximum probability of minimizing resource expenditures on compliant imports.

COMPLIANCE MEASUREMENT

The primary purpose of the CM program is to ascertain trade law port-of-entry compliance from the time of cargo entry to entry summary liquidation by collecting data and information through a process termed stratified sampling. All imported cargo entry lines declared to Customs during a fiscal year constitute the sampling population. The sampling consists of three segments: Baseline (all harmonized classifications), PFI's, and CA accounts. The sample size was derived based on the first four digits of the HTS numbers using an allocation method that reflects Customs' work-load characteristics and compliance history.

There are industry sectors that Customs considers important that have received focused attention in recent years. These industry sectors are referred to as PFI and are defined by ranges of HTS. In addition to the baseline sample, additional entry lines are selected from some 4- or 6-digit HTS numbers that are identified as having a high concentration of PFI commodities.

Customs also samples shipments from specific accounts. Accounts that have completed a CA are sampled according to their Compliance Risk Category: highly compliant, compliant but lacking an effective internal control system, and non-compliant. Ranging from 30 to 220, the sample size for these accounts is based on the risk category to which the account is designated. In addition, accounts with serious, ongoing compliance problems are placed into a “confirmed risk” category and sampled according to their actual compliance rate.

In summary, the sample size is determined by 4-digit HTS number for baseline, by 4- or 6-digit HTS numbers for PFI, and by category for CA accounts. The actual sampling rate is then calculated as a percentage of the corresponding population and implemented to select the sample from the population.

Allocation Method (Risk Score)

An allocation method allows Customs to select a larger sample for commodities that are considered important (high risk), and a smaller sample for commodities that are deemed less important (low risk). It also allows Customs the flexibility to define or choose specific factors that reflect the importance of the commodities. The sample size is allocated based on the 4-digit HTS numbers. A total of four variables have been used in the sample allocation process: population size (total entry line count), total value, average value per line, and HTS compliance rate as determined by the CM program.

A risk score is calculated based on total value, average value and discrepancy rate. The purpose of risk score is to provide an index for reflecting the importance of each 4-digit HTS number relating to Customs' workload and focus. The sample size is allocated according to a factor which is the product of risk score, population size, average value, and variance of discrepancy rate.

Before the allocated sample sizes are adopted, they are evaluated from two prospective angles: the expected precision of the compliance estimates (at 95 percent confidence level) and the expected number of entry lines that would be available for revenue estimations. The expected precision, i.e., margin of error at 95 percent confidence, of the estimates by 4-digit HTS numbers indicates that the allocated sample sizes indeed provide highly reliable estimates of compliance for major commodities.

Defining Strata and Weighting Scheme

Even though the sample size is allocated by 4-digit HTS number, these HTS numbers should not be confused with sampling strata. The sample size for each 4-digit HTS number varies widely. To stabilize the sample weight, these 4-digit HTS numbers are combined according to the comparability of the sampling rate to form broader sampling strata. A weighting scheme accounts for various strata and different sampling rates.

Because the sampled populations of the baseline and PFI overlap, and because CA account sampling is modified on a quarterly basis by adding additional CA accounts, the overall process of counting the population and sample and developing the weighting scheme is relatively complicated. However, sufficient care is exercised to ensure that the entire process is statistically valid.

COMPLIANCE ASSESSMENT

The Compliance Assessment is one tool Customs uses to measure the risk level of major importers. The results are incorporated into the Risk Management Process in an effort to identify and measure risk. They work in concert with other options that are designed to make importers aware of the need to confront low compliance rates and take appropriate action in a cooperative effort with Customs. Led by auditors, CA's are conducted by a cross-functional team representing several Customs disciplines. This allows Customs to measure the companies' compliance in all areas.

The total number of importers into the United States is more than 400,000. In order to deal with that volume, a decision was made to expend the major percentage of auditor resources toward those importers presenting the most risk. Therefore, Customs has stratified the importer workload to identify the top 1,000 importers by entered value and the top 250 importers in each PFI, also by entered value. Consequently, the importers selected for CA's are picked from those which represent the bulk of Customs' workload and are in industries which are considered the most critical to the U.S. economy.

To conduct a CA, Customs:

- Meets with the importer; gives importer questionnaires
- Develops an account profile
- Evaluates the results of the importer questionnaires
- Reviews the importer's accounting, automation, and internal control systems
- Selects samples
- Tests the samples for compliance
- Computes compliance rates
- Determines the causes of non-compliance
- Recommends actions to address the non-compliance
- Issues Compliance Assessment report

The use of statistical sampling in conducting the CA is an effective way of scientifically quantifying the compliance rate of the importer, or, put another way, evaluating the importer's risk level in the critical areas designated and tested with a built-in error rate allowance. Customs, by designating a compliance rate standard, sets the benchmark for the level of risk that can be tolerated or which requires additional focus.

The results of the CA are factored into the Risk Management Process. If found compliant, the importer will receive a lessened degree of Customs review and exams. The importer will not be subject to another CA for several years and is eligible for other Customs programs designed to benefit the importer. If not compliant, additional measures are taken for corrective action.

IMPORTER COMPLIANCE MONITORING PROGRAM

The Importer Compliance Monitoring Program (ICMP) is an initiative intended to promote compliance with Customs laws and regulation. Similar to a Compliance Assessment, the ICMP involves a systematic overview of a company's import operations, and includes both process and transaction reviews. However, reviews are not performed by Customs. Ideally, a group independent of the company's importing function will conduct the required reviews. Alternatively, companies may elect to use outside professionals. Process reviews will include an annual preparation or updating of a flowchart and narrative of the company's import process. Transactional reviews will utilize statistical sampling methodologies. Sampling errors will be evaluated based on the number and materiality of errors. Where applicable, a Compliance Improvement Plan will be prepared by the importer and submitted to Customs outlining actions taken or proposed to correct cited deficiencies. The ICMP is voluntary on the part of an importer. Importers approved for participation in the program consult and coordinate with Customs. As necessary, Customs will validate the importer's ICMP process and transactional reviews.

NATIONAL CRITERIA(CARGO SELECTIVITY)

In the past few years Customs has experienced major changes in many areas of operation, and these changes, by necessity, have caused an evolution in the basic philosophy and use of automated selectivity criteria. Among other major developments, the intensive use of CM and the emphasis on specific large accounts have made it imperative that selectivity criteria adapt to support these changes and ensure a coordinated, effective Customs operation. Selectivity criteria are a means for Customs to target specific entities. The criteria input is subjective in nature, based on past experience and lessons learned. The subjective criteria are not to be confused with the statistical random sampling used in CM's. The selection process used in CM is purely random and the input is based on objective numerical analyses. The national selectivity referred to here is Customs' means to target and obtain data on suspected non-compliance.

Areas of Responsibility

One national Customs office is responsible for the review, creation, monitoring and maintenance of national commercial selectivity criteria, including other agency criteria which contain regulation criteria affecting various tariff numbers.

Referrals for the creation of selectivity criteria are received from numerous sources but primarily from field units. Referrals are generally based on prior discrepancies or seizures, suspicion or allegation of violations, and other agency requirements. In addition to creating criteria, the National Customs Office also deactivates criteria when an action is complete and negates (stops) criteria for shipments within the universe not requiring Customs review.

Active criteria are monitored on an ongoing basis and are evaluated, updated or deleted as needed.

National Criteria Parameters

All assertions/seizures/enforcement actions deemed to be significant enough (PFI, public health and safety, revenue loss, quota, seizures, etc.) to warrant local criteria and believed to have potential national applicability are for-warded to a central office for national criteria consideration. Customs integrates the submission into the context of other account related programs. For example, the account referred by the port for criteria is reviewed regarding its possible CA status and compliance risk category. The creation of criteria for additional exams is questioned if Customs has already determined that the account is highly compliant. Customs further integrates the submission, if necessary, into the context of any enforcement initiatives. Feedback is provided to the submitting office regarding the final resolution of the criteria submission.

The review of all local criteria submissions for consideration to national status serves as a means to ensure greater uniformity in the treatment of accounts relative to examination policy. Any inconsistencies in an account's status and treatment under various Customs initiatives (CM, CA, national/local selectivity, etc.) are identified and resolved with the relevant offices.

ACCOUNT MANAGEMENT

For Customs largest, most complex importers within PFI's, the results of a CA are used to evaluate the account and identify compliance problems. However, resources do not permit a CA or a statistically valid number of CM exams for each and every account.

For these accounts, Account Managers must reach out beyond the quantitative data available. The Account Activity Tool (AAT) provides Account Managers with three years worth of data on the account's importations. While not statistically valid, it is often enough to provide an indication of compliance problems. With this data in hand, the Account Manager gathers information from Customs ports and other disciplines, issues a questionnaire to the account and conducts an interview with the account.

Topics for the questionnaire and interview are tailored for each account and include:

- General organizational information
- Customs-related activities
- Record keeping system
- Internal controls
- Customs value information
- Admissibility
- Information management
- Filer relations
- Classification
- Country of origin
- Electronic data interchange
- Inventory controls
- Vendor programs
- Future plans
- Account's issues/concerns with Customs

Using this information, the Account Manager, in conjunction with other Customs experts, is able to make a judgment as to the account's knowledge of Customs regulations, the nature and quality of its internal controls, and its current level of compliance (discussed in additional detail in the Analyze and Assess Risk section).

Analyze and Assess Risk – Step 2

After collecting the data, the next step is to analyze the data and determine the likelihood of non-compliance. Analyzing historical data and trends, and applying definitions of significance and materiality, allow Customs to narrow its focus on areas of the greatest potential risk. Once data points to a compliance problem, Customs conducts further analysis to determine the scope or magnitude of the problem. Facts taken into consideration include, but are not limited to:

- Materiality/significance of the problem based upon established guidelines
- Number of ports impacted
- Value and volume represented
- Portion of industry impacted — one account, a few accounts, or an entire industry
- Laws and regulations that may be violated
- Commercial issues involved, entries impacted, loss of revenue
- Other Customs entities involved (Account Managers, CA leaders, etc.)
- Whether the non-compliance represents an isolated incident or a possible pattern of non-compliance
- Identification of previous actions taken (informed or enforced compliance)

After this analysis, some level of risk can be assessed. This part of the Risk Management Process has evolved rapidly within the last year and the Customs Risk Management Team is working to increase the sophistication and accuracy of Customs risk assessment. Today, the components of the Analyze and Assess Risk step include:

- Automated tools
- Significance and materiality definitions
- Compliance Risk Categories
- Enforce Impact Levels
- Account Management evaluations

AUTOMATED TOOLS

Customs is redesigning its automation in conjunction with the redesign of its trade process. The future Automated Commercial Environment (ACE) will be an integrated system, offering user-friendly analytical tools to personnel at every level and enhancing Customs' processing abilities for the trade community. Customs current trade system, ACS, is the third largest database in the world, and the migration from ACS to ACE will take sometime. In the interim, several analytical tools have been developed to allow trade personnel to organize, aggregate and employ user-friendly interfaces to the raw data in ACS.

Since no one single analytical tool yet exists that meets all of Customs' analytical needs, several tools such as Customs Automated Port Profile System (CAPPS), the Trend Analysis and Analytical Selectivity Program (TAP), the Account Activity Tool (AAT), and the Macro Analysis Targeting System (MATS) fill the need. Combined, these tools allow employees to identify and assess potential compliance problem areas. They allow the user to view trend graphs of aggregated data and identify major players in the alleged problem area. This includes importers, manufacturers, brokers, countries and ports. Some of the tools also allow users to perform verifications or reviews of specific transactions within the problem area.

SIGNIFICANCE AND MATERIALITY DEFINITIONS

In 1998, Customs further narrowed its focus by acknowledging that all violations were not of equal importance. Customs developed significance definitions for violations discovered while examining and reviewing transactions and materiality definitions to use when conducting CA's.

Compliance Measurement Significance Definitions

All violations discovered during a cargo examination or entry summary review are recorded and addressed appropriately. These violations are defined as "letter-of-the-law" violations. No matter their seriousness, they are violations. After this initial determination, definitions are applied which measure the violation's "significance." While all violations will be recorded and reported, identifying significant violations allows Customs to further focus its resources on its most serious problems. The specific significance definitions are not released as public information. However, considerations are made for narcotics, Intellectual Property Rights, admissibility, misdelivery, anti-dumping and countervailing duties, quota/visa, PFI, HTS chapter, and value.

Compliance Assessment Materiality Definitions

CA's include the use of statistical testing of transactions to determine if importers have internal control systems that produce accurate and complete Customs information. Based upon the results of the testing of these individual transactions, a compliance rate is computed for each of the major areas covered during the CA. For each CA there are checks called "common checks" for which a compliance rate is determined. Compliance rates are also computed for "conditional check" trade areas (special trade programs and trade focus areas) depending upon their significance and relevance. Generally speaking, compliance rates simply measure the number of times sampled transactions are correct.

A process for reporting the materiality of discrepancies found during a CA was developed to provide for consistent treatment of errors noted during compliance testing. More importantly, computing a materiality rate provides perspective to the "letter-of-the-law" rate, which allows for a comparison between the CA and CM results for classification, quantity, and value.

The CA process calls for computing a "letter-of-the-law" compliance rate for classification, quantity, reported transaction value, record keeping, and certain "conditional check" trade areas. If the letter-of-the-law compliance rate is below the acceptable rate of 95 percent in classification, quantity, reported transaction value, and certain "conditional check" trade areas, a materiality compliance rate is computed. This reflects the effect or significance of the errors on Customs and on the importer's overall compliance. The CA report includes both the "letter-of-the-law" and "materiality" compliance rates.

If any compliance rate is below 95 percent, the cause and effect of the poor compliance is analyzed to determine what plausible corrective action is necessary for the importer to achieve compliance. Compliance rates are the driving factor for the risk recommendation made at the conclusion of the CA.

The specific materiality definitions are public information and are included in the Appendix.

COMPLIANCE RISK CATEGORIES

Upon completion of a CA, the CA team reports its findings. As determined by the statistical results of the CA and the materiality definitions, an importer is placed into one of three categories. The categories denote the number of CM examinations that will be assigned to the importer. Poor compliance means higher risk and therefore, more examinations. The level of cargo examinations is applied until the importer implements corrective action and attains compliance of at least 95 percent. Categories and exam allocations are as follows:

(1) High Compliance, Good Internal Control Systems/Low Risk — minimal CM exams The importer passed the assessment with above a 95 percent compliance result. The importer also demonstrated reasonable care in administering its business practices. This company poses low risk to achieving trade compliance goals.

(2) High Compliance, Suspect Internal Control Systems/Moderate Risk — average number of CM exams. The importer passed the assessment with above a 95 percent compliance result. However, the importer did not demonstrate reasonable care in administering its business practices. This company poses moderate risk to achieving trade compliance goals.

(3) Low Compliance/High Risk — significant number of CM exams. The importer failed the assessment, with a score below 95 percent. The importer did not show reasonable care in administering its business practices. This company poses high risk to achieving trade compliance goals.

ENFORCE IMPACT LEVELS

To ensure uniformity of enforcement actions across ports, and to ensure Customs' enforcement resources have the greatest effect, Customs enforcement decisions are also guided by significance guidelines. These guidelines are called Impact Levels. They complement the significance and materiality definitions for CM and CA and are used specifically to address use of enforcement resources.

Level 1 - High Impact

These discrepancies/possible violations have the highest level of impact on domestic industry, public health and safety, and/or protection of the revenue, and as a consequence warrant the highest degree of enforcement response. Customs devotes the maximum available enforcement efforts and resources to remedy such non-compliance/potential violations.

Level 2 - Medium Impact

These discrepancies/potential violations impact domestic industry and/or protection of the revenue at a level warranting an enforcement response, but do not meet Level 1 criteria. Customs devotes the appropriate enforcement efforts and resources necessary to remedy such discrepancies/potential violations.

Level 3 - Low Impact

These instances of non-compliance/potential violations are not at a level warranting an enforcement response, and are better remedied through informed compliance or other non-penalty action with the involved account. Customs does not devote enforcement efforts or resources to remedying non-compliance at this level. Non-compliance/potential violations are Level 3 matters if they do not meet Level 1 or 2 criteria. Aggregation of Level 3 violations which indicates a pattern or trend of discrepancies/possible violations may warrant an increase to Level 2.

ACCOUNT MANAGEMENT EVALUATIONS

Not every account undergoes a CA. If there is no CA, the combination of data collection and account interviews is used to complete evaluation. Without a CA, a specific Compliance Risk Category is not assigned. However, by creating and analyzing an Account Profile, areas where both Customs and the account should focus resources become apparent.

Customs uses information on the account (gathered through data analysis, issuance of a questionnaire to the company, and interviews with the account) to create the Account Profile. The profile includes information such as: the account's corporate structure, locations, relationships to other companies, detailed analysis of its importing history, comparison to industry norms, and identification of possible compliance problems.

The profile is a key document. It allows the Account Manager to begin narrowing his or her focus with the company to address crucial compliance problems. Data used to compile the profile is made available to the company via the Freedom of Information Act process so that it may conduct its own analysis if it wishes.

After thorough analysis of the profile, problem areas such as classification, quota, and NAFTA requirements are identified and a detailed action plan is developed (described in detail in the Prescribe Action section).

Types of information detailed in an Account Profile include: account identification information; Customs program participation; trade statistics; trade issues (such as classification, transshipment, Intellectual Property Rights); cargo examination history; CM history; laboratory reports; informed compliance efforts; revenue activity; and enforcement activity. A sample profile is included in the Appendix.

Prescribe Action – Step 3

Data collection and analysis alone do not constitute a fully developed risk management system. Once these activities are complete, some remedy must be implemented to reduce risk and increase compliance. This step requires two distinct actions: (1) identifying the cause of the risk, such as an importer's lack of knowledge, complex trade laws, or willful disregard for import laws; and, (2) designing an action and assigning resources to address that risk.

When assigning resources, Customs takes into consideration personnel availability, training needs, cost, and performance measures.

Personnel availability

One of the most important activities of putting any risk management plan into effect is to have the right skills and tools available to address risk areas. It is critical to match the personnel with the task to maximize the effectiveness of an action plan. While this might seem like an obvious statement, it is often difficult to identify the best course of action to minimize risk and therefore, the personnel best suited for the task.

Training needs

An estimation of the training (if any) necessary to implement the action is required. Sometimes this training is available through Customs courses offered regularly at the U.S. Customs Training Academy. Other times, it is offered just-in-time by in-house experts or external trade experts.

Cost

A cost estimate and proposed time frame for the action are developed prior to implementing actions.

Performance measures

Prior to implementation, Customs designs performance measures linked to national goals and objectives. In developing measures, comprehensive indicators, those that show a ratio of expected results to actual results, are preferred, as opposed to indicators that only show work completed. Some examples of comprehensive performance measures are compliance with NAFTA and rate of quota violations.

Finally, the appropriate remedy is designed. Over the last few years, Customs has developed a variety of tools to actively address high-risk areas. These tools span a range of activities from instituting laws and regulations creating a voluntary compliance system to aggressive enforcement to address some of the most grievous non-compliance. Each of these tools feeds into the overall Customs mission to maximize trade compliance through a balanced program of informed compliance, targeted enforcement actions, and the facilitation of compliant cargo.

Customs' actions to address non-compliance are categorized as either informed compliance or enforced compliance. The menu of options now available within informed and enforced compliance includes:

- Interventions
- MARC 2000
- Compliance Improvement Plans
- Account Action Plans
- Enforcement Evaluation Teams
- Company Enforced Compliance Process

While many of these elements can stand alone as separate entities of risk management, together they work to address the overall needs of Customs. Coordination of these efforts is crucial. It is important to reflect upon each piece of the process in light of the whole.

INFORMED AND ENFORCED COMPLIANCE – OVERVIEW

Within its Trade Compliance Process, Customs has two complementary means for ensuring that importers, Customs brokers, carriers and other members of the international trade community comply with U.S. trade laws: informed, voluntary compliance and enforced compliance. Informed, voluntary compliance is the preferable approach to trade compliance. However, when voluntary compliance is not achieved, Customs takes enforced compliance actions against violators.

When determining which approach to take, the nature, scope and impact of non-compliance are evaluated in the context of the involved account's overall compliance history. Informed compliance actions, such as increased out-reach, education and counseling of the account are employed by Customs to address instances of non-compliance when an account has demonstrated a failure to apply reasonable care. Enforcement actions such as seizure and investigation are reserved for those instances of egregious violations, fraud, or ongoing, repetitive violations that could not be solved through informed compliance.

The overall goal is to select the correct approach and employ the right tools to remedy past violations and promote future compliance.

INFORMED COMPLIANCE

Customs defines informed compliance as a shared responsibility wherein Customs effectively communicates its requirements to the trade, and the people and businesses subject to those requirements conduct their regulated activities in conformance with U.S. laws and regulations. Poor compliance is analyzed to assist the account in determining what plausible corrective action is necessary. The Customs Modernization Act (Mod Act) provisions of the NAFTA Implementation Act of 1993 assign Customs the responsibility for clearly defining and communicating the responsibilities of the trade community. In return, it requires the trade community to act with reasonable care in meeting those responsibilities.

Examples of informed compliance include:

- Intervention Process
- Most Account Management activities
- Account Action Plans
- Compliance Improvement Plans
- Binding rulings
- Seminars
- Importer premises visits
- Industry roundtables and workgroups
- Video tapes
- Industry and commodity specific publications (are available on the Customs web site)
- Sharing with an importer its historical trade data and trends

The Intervention Process

One of the tools used by Customs to confront non-compliance is the intervention. Customers for interventions and intervention reports are domestic industry, importers, other government agencies (such as U.S. Trade Representative, Department of Commerce, and the Food and Drug Administration), and offices within Customs. An intervention is a set of Customs actions taken in response to identified or potential patterns of non-compliance with trade laws; in other words, it is a problem-solving approach to maximize compliance. It is national in scope (i.e. not just one port). It addresses a problem affecting one of the PFI or “watch list” areas or a trade enforcement priority.

The steps in an intervention include:

- Determine risk from repeated non-compliance
- Design the intervention strategy
- Scope
- Activity
- Training Requirements
- Personnel Requirements
- Develop Performance Measures
- Implement and Coordinate
- Monitor and Report

Strategies may involve field operations, audits, training, meeting with the trade, gathering more data, etc. Some examples of proposed actions include: specific instructions, for example, intensive exam versus document review; an informed compliance plan; imaging and/or lab analysis; training programs; and verification visits.

As a part of the intervention process, the Strategic Planning Board (SPB) was created to address some of the more fundamental questions of resource allocation associated with risk. The SPB is a multi-disciplinary body that is made up of members of the Office of Strategic Trade, the Office of Field Operations, the Office of Investigations and other offices as needed. In order to effectively come to terms with risk management this body operates to address substantive and conceptual problems such as: the scope of work that will be addressed; prioritization of resources; establishment of measures; coordination of local and regional issues; and methods of tracking results. All interventions are presented to the field for comment and approved by the SPB prior to implementation.

During the life of the intervention the SPB receives status reports and the field makes any necessary adjustments. At the conclusion of the intervention, the SPB reports the findings and makes recommendations for any further action as necessary.

Examples of Intervention

Critical Components –Fasteners

An issue existed in the classification of screws and bolts. Screws are frequently mis-classified as bolts because of a lack of technical knowledge regarding their proper tariff classification, or in an attempt to avoid higher duty rates presenting a significant risk of loss of revenue. Two interventions were developed utilizing an informed compliance approach. Automobile manufacturers and other significant fastener importers with low screw-to-bolt import ratios were contacted and sent copies of an informed compliance publication to help them distinguish bolts from screws. The importers were asked to review their importations of fasteners to ensure the screws and bolts had been properly classified. Importers who refused to cooperate were dealt with using enforced compliance techniques. As a result of the interventions and the cooperation of many of the importers, over \$3.2 million in lost revenue was recovered, with a potential \$1 million more depending on the outcome of a case before the U.S. Court of International Trade.

Autos

Analysis suggested that many large auto companies were using a basket provision (or “other” category) inappropriately. Many items being classified as “other” had specific designations in the tariff. The “8080” intervention was developed and Customs used informed compliance to address this problem with the auto industry. With just one company, it was discovered that it had classified more than 10,000 different items as “other”. After working extensively with Customs and their broker, the account reclassified all but 164 of the 10,000 items into specific categories.

MARC 2000

MARC 2000 is the Multiport Approach to Raise Compliance by the year 2000 project. It evolved from a 9-month test where 12 ports devised plans to increase local port compliance in a particular area. These ports identified and targeted specific areas which contributed to low compliance in their ports and implemented strategies to raise compliance. MARC 2000 is the next evolution of this project where multiple ports, which share the same compliance issues, come together to formulate a national plan aimed at raising compliance in a specific area. Primary and secondary ports are then asked to devise local activities based on the national plan. Ports with smaller volume are also asked to follow the national plan in their regular course of business with the identified commodities.

This program strives to raise overall compliance, promote uniformity, and inform the trade. The first six projects are: Production Equipment, Bearings, Gloves, Whole Autos, Revenue, and Express Consignment Facilities. All of the plans have incorporated an outreach component as an integral part of the plan, but each is tailored specifically for the industry based on non-compliance issues and concerns.

There is also a role for the trade community. It is encouraged to take advantage of the informed compliance aspect of this program by attending Customs sponsored seminars, inviting Customs to speak at association meetings, and by exercising reasonable care when entering merchandise into the commerce of the United States.

Compliance Improvement Plan

When a Compliance Assessment indicates the need for corrective action by the importer to ensure future compliance, the related CA report recommends that the importer prepare and implement a Compliance Improvement Plan (CIP). The importer works in concert with the CA team, to develop the CIP and the time line for its implementation.

CIP's outline the specific deficiencies that the importer needs to correct, how the system will be changed (what corrective actions will be taken), and the time frame for taking those corrective actions. Depending upon the nature of the deficiency and its related cause(s), a CIP can vary in the degree of corrective action(s) needed to eliminate the deficiency and, if applicable, achieve compliance. In cases where the issue is systemic in nature, the corrective action may very well be a simple quick fix. Other times, enhancements to internal controls may be required which may take some time to develop and to implement. In either instance, the CIP specifically identifies the nature of the corrective action in sufficient detail to understand the relationship between the deficiency and the correction. Responsible importers usually validate their corrective actions prior to advising Customs that their CIP is fully implemented and the deficiencies surfaced in the original CA report have been fully corrected.

Account Action Plan

After accounts undergo some type of evaluation – either via a CA or Account Manager evaluation - both the Account Manager and the account must identify specific compliance problems and remedies for these problems –the account action plan.

This action plan identifies goals, steps to reach those goals, and estimated completion dates. It is an important tool to measure the progress of the account in achieving and maintaining maximum compliance. It also includes issues the account would like Customs to address, such as uniform cargo release procedures among the ports. The plan is brief yet clearly outlines action items, responsibilities and a time line. Plans vary from one account to another. However, certain key elements are always included: common checklist, account background and structure, scope of plan, and project list (including action items and responsible parties).

The action plan is dynamic. The account manager works with the company to ensure progress is made. New action items are added as identified and issues are removed as they are resolved. The account manager provides interim updates as changes occur (e.g., a major change in the account's structure or business). Plans are reviewed with the account at least annually, and updated and renegotiated as necessary. A sample action plan is included in the Appendix.

ENFORCED COMPLIANCE

There are times when informed compliance is not appropriate. This occurs after ongoing informed compliance efforts have failed to resolve repetitive compliance problems or when there is an egregious violation, such as fraud or an illegal import that impacts the public's health and safety.

Examples of enforced compliance include:

- Investigation
- Seizure
- Arrest
- Penalty
- Administrative action (such as live entry or single entry bond)
- Additional exams (through targeted criteria)
- Exclusion from some Customs programs

These actions require significant resources and are used when they will have the greatest impact. The challenge is determining which action — informed or enforced compliance — is most appropriate, remembering that the goal is future increased compliance.

Customs employs several enforced compliance tools. Two key approaches are the Enforcement Evaluation Teams and the Company Enforced Compliance Process.

Enforcement Evaluation Teams

Customs traditionally has responded to instances of non-compliance with specific enforcement actions. Seizures are made in response to cargo issues; investigations and penalties are pursued. Enforcement action, however, may not be the only, or best, way to resolve a given non-compliance problem. In some instances, out-reach and counseling of an inexperienced importer may more readily result in compliance. When enforcement action is warranted, the degree of that action and the level of Customs resources dedicated to that action are guided by the scope and impact of the violation.

Customs established Enforcement Evaluation Teams (EET's) to: 1) make an early determination of the nature, extent and impact of instances of non-compliance; 2) select the Customs response best suited to remedy the problem; and 3) follow-up on that action to ensure the non-compliance problem is solved. The EET ensures that significant discrepancies and possible violations are treated uniformly on a national and account-wide basis. This is accomplished through the use of multi-disciplined groups and by ensuring early legal counsel and seizure/penalty advice on significant issues of non-compliance.

The basic steps followed by all EET's are:

- Detect non-compliance
- Determine impact level
- Analyze violation/determine scope
- Select course of action
- Assign, implement and track course of action
- Conduct post-enforcement analysis

A flow diagram and more details on this process are included in the Appendix.

Company Enforced Compliance Process

The Company Enforced Compliance Process was designed to identify and take action on those accounts with the most serious ongoing compliance problems. Compliance Measurement is used to identify companies which register below 90 percent overall compliance rate based on a statistically valid examination rate.

This information is filtered through the other segments of the Risk Management Process, i.e., CA results, interaction between the company and the Customs Account Manager, Customs industry experts, investigators and impacted port personnel.

The companies that fall below 90 percent and are not making progress in existing compliance programs are designated as “confirmed risk.”

- A confirmed risk designation causes the company to transition from an informed compliance approach to an enforced compliance approach.
- Companies are informed, in writing, that they do not meet the acceptable level of compliance and that additional actions will be taken.

An enforced compliance designation causes a series of actions which may include the following: performing CM examinations at the actual level of registered compliance; initiating an investigation; imposing fines and penalties; and requiring complete documentation prior to cargo release.

Accounts are continuously monitored for changes in their compliance percentages. If compliance does not improve through ongoing programs, the company is reintroduced during the next compliance quarter for enforcement action.

Track and Report – Step 4

Once the appropriate action is designed, ownership and responsibility for that action must be assigned and its results must be tracked and fed back into the Risk Management Process. Ensuring that actions are implemented and reporting their results are critical to the cycle of identifying and eliminating future risk.

Customs employs several tracking and reporting mechanisms:

- Trade Compliance and Enforcement Plan
- Report to Congress on Trade Compliance
- Account Management
- Follow-up Verifications

These plans and reports call for strict adherence to steps that will alleviate compliance concerns that led to the risk determination. To ensure risk is adequately tracked, it should be made an agenda item at every formal meeting and review. Openly discussing risk provides an opportunity for all concerned to offer suggestions for the optimum approach to reducing risk to an acceptable level. Communicating risk improves awareness and allows early action to minimize adverse consequences. Finally, information and knowledge gained in this step are fed back into the Risk Management Process. This feedback can be input into any step. A change in priority of risk would require new input into the Assess and Analyze Risk step; a need to modify an action plan would require a return to the Prescribe Action step. Since risk is never absolutely known, results and experience must be fed back into the process to narrow the knowledge gap and better predict future risk.

TRADE COMPLIANCE AND ENFORCEMENT PLAN

The TCEP, discussed in detail in the Building the Foundation section, outlines the work of the Trade Compliance Process for one year. As the year comes to an end, a detailed evaluation is conducted for each of the sub-plans to assess progress made. The results obtained from measuring this performance are incorporated into the following year's plan. Compliance results are also included in Customs' annual Performance Report, presented to Congress each year with the budget submission.

REPORT TO CONGRESS ON TRADE COMPLIANCE

The report to Congress is required by the Customs Modernization Act included as part of the North American Free Trade Agreement (NAFTA) Implementation Act (1993). Its purpose is to provide an objective assessment and measurement of compliance with United States trade laws and regulations. The data in this report represents the basis for Customs' new approach to maximizing its effectiveness by developing strategies and methodologies to meet the demands created by the continuing growth of international trade.

The report also provides Customs the opportunity to present a summary of the key initiatives undertaken to address more effectively the compliance issues identified through our measurement program.

ACCOUNT MANAGEMENT

Account Managers also track their accounts' compliance progress to ensure compliance problems are resolved. After developing the action plan with the account, the Account Manager continues to monitor the account's activities, identifies new improvement opportunities, and with the Account Activity Tool, measures the account's progress. If progress is not being made and ongoing management of the account shows that serious compliance problems continue, the Account Manager refers the problem to an Enforcement Evaluation Team (Step 3 - Prescribe Action) for review and action.

FOLLOW-UP VERIFICATIONS

Follow-up reviews are conducted to determine if the corrective actions, as determined by the importer, and identified in the importer's Compliance Improvement Plan, were fully implemented and effective in correcting the deficiencies identified during the CA. Generally, follow-up reviews are not performed on low-risk importers, unless special circumstances exist. If internal controls were found to be inadequate, but compliance was acceptable, the follow-up review is often limited to just verifying the implementation of the internal controls. In these instances, transaction testing may not be warranted, particularly if CM rates remain acceptable. If the importer had significant compliance problems, beyond inadequate internal controls, a site visit is conducted, and a sample is drawn so that transactions can be tested in order to reassess compliance.

Follow-up reviews are conducted after all corrective actions are implemented by the importer, a reasonable time frame has elapsed, and a sufficient number of transactions exist, so that a representative sample can be selected for testing. The scope for a follow-up review is directly related to what was found during the initial CA. The amount of detailed work is relative to the number of common checks/special trade areas that were found to be non-compliant during the initial CA, as well as, the causes for the deficiencies and resultant corrective actions taken by the importer. Normally, follow-up verifications are conducted about one year after the initial CA.

The results of the follow-up review reflect whether or not the importer has fully implemented the corrective actions contained in the CIP and whether or not the importer has achieved compliance of at least 95 percent. In the event that the importer has corrected the deficiencies contained in the initial CA report and is at least 95 percent compliant, the measurement process is adjusted and the importer then receives the level of cargo examinations associated with a low-risk importer. On the other hand, continued non-compliance may result in other enforcement actions.

Future Developments

The U.S. Customs Service Risk Management Process is constantly evolving. It is not a static process. This publication simply outlines the process as it exists today. Customs' next priority for risk management is to further integrate the components of the process, such as Account Management, Compliance Measurement, Compliance Assessment and Enforcement Evaluation, into a single, dynamic system that one could easily understand and that others could replicate. Future elements of Customs Risk Management Process include:

- Risk Management Team
- Risk Assessment Enhancements
- Issue Management System

RISK MANAGEMENT TEAM

A Risk Management Team was recently established at Headquarters to further design, coordinate and implement Customs' Risk Management Process. The team will work to identify and define known critical processes, facilitate the identification and analysis of new risk areas and related processes, assist in the development of plans to take action on risk, and develop a more comprehensive system to track and report risk activities.

The continued, proactive, dedicated focus of this team will be critical to the success of trade compliance programs and initiatives.

RISK ASSESSMENT ENHANCEMENTS

Customs' experience in assessing specific risk scores for industries, accounts and transactions goes back only a few years. This is an area of great interest and Customs is moving forward, developing a more sophisticated and precise risk assessment component to the process — one in which there is a more direct correlation between the risk of non-compliance and the actual compliance levels. Work in this area is in its infancy, but could include such elements as targeted account ratings or a risk assessment card.

Targeted Account Ratings

Customs is exploring the possibility of an automated tool for identifying and evaluating levels of risk for selected accounts. The tool would be a database with several years' worth of data for accounts. Risk areas and specific risk criteria would be weighted to reflect current trade practices and priorities. Data calculated for each risk criteria would then be normalized across each of the accounts.

This methodology would emphasize data analysis and would be much less subjective than tools available in account management today. A final stratification of accounts by risk score, coupled with the delineation of the specific areas of vulnerability, would enable Customs to make informed judgments on which resources to dedicate to which accounts.

Risk Assessment Card

Another possibility is the development of a Risk Assessment Card concept. This concept would integrate two sets of information, combining the likelihood of the event occurring and the severity if it does.

Risk Assessment Card for commercial non-conformity

Level in relation to the objective of commercial conformity

Risk assessment

- High – Priority attention is required in terms of management
- Medium – Some management may be required
- Low – Minimal surveillance required CONSEQUENCE

Consequence

What is the scope of the impact?

As the figure above indicates, two questions would be asked: How far is the event from the compliance goal (variance)? What is the magnitude of the impact (consequence)? These would be rated A-E and 1-5 respectively. A final decision on the level of risk would be made with the combination of the two.

Issue Management System

Customs also plans to develop a more comprehensive system to track and report its risk management actions. The Issue Management System (IMS), a system built to help evaluate the intervention process, would be expanded to support the entire Risk Management Process.

- Collect Data and Information – Prior to collecting new data, or prescribing new actions, the IMS would be queried to see if the same or similar work has already been completed somewhere else. An IMS user could review all relevant information pertaining to an analysis or intervention and see the results prior to making the decision to commence additional work.
- Analyze and Assess Risk – Information stored in the IMS or compared to a new set of facts could help determine the level of risk that an issue poses to Customs. For example, an IMS record exists for 30 countries with no known bearing production capability. In this case, an insignificant number of bearings were being shipped to the U.S. from non-producing countries. Subsequent research determined that wrong country of origin codes on the entry packages were used and that there was no loss of revenue or AD/CVD circumvention. In essence, it was a clerical error that posed little risk to Customs because the shipments were identified as being from a non-producing country in error. On the other hand, if we started to get significant bearing shipments from one of those 30 countries, a significant risk of AD/CVD circumvention may have been identified that requires a closer look because past analysis confirmed that there is no bearing production in that country.

- Prescribe Action – The IMS would store our best practices. The system could be queried to help identify and implement strategies that have shown success in the past. Conversely, the IMS could be used as a tool that steers us away from strategies that have not been fruitful.
- Assign Resources - Resource assignment and allocation based on the number of hours spent on an action could be stored within the IMS by position type and port. For an issue that required resource allocation, the IMS could store both estimated and actual hours worked by position type and port. This should eventually allow for the calculation of the estimated cost of our activities. This information would be fed back into the Risk Management Process to ascertain the return on our resource expenditures.

Conclusion

As the U.S. Customs Service Risk Management Process has evolved, we realize that neither the importance of a systematic approach, or the difficulty in implementing it, can be overestimated. We are constantly striving to study new approaches and incorporate best practices. We hope that by sharing this document with other countries, agencies and companies, others will better understand our approach and work with us to build an integrated, international risk management approach to trade.

Additional case studies and process details are included in the Appendix. If you have questions about our Risk Management Process or would like to share other successful practices with Customs, please contact the Risk Management Team 202-927-0200.

Glossary of Terms

Account - A commercial entity or group of entities dealing with the Customs Service.

Account Action Plan - A written plan, prepared by the Account and the Account Manager, that includes specification items that address compliance deficiencies and methods for reducing the cost of compliance.

Account Activity Tool - A planning tool that contains information which will aid National Account Managers and Port Account Teams in performing research and analysis on their account. Provides ACS and Census line item information (value, tariff numbers, ports of entry, etc.) on an importer for the current year and the previous three years. Includes cargo exams, entry summary reviews, compliance measurement, bills, refunds and protest.

Account Management - Customs' approach to managing its work through accounts rather than individual transactions. Account Management maintains a constant liaison with the company, provides information under the principle of informed compliance, and helps the company identify and resolve any areas of non-compliance. This concept is based on the fact that approximately 2 percent of all importers import about 80 percent of all merchandise by value. Improving the compliance levels of these importers, or accounts, is more effective and efficient than attempting to deal with compliance at the individual import entry (transaction) level. Account Management reflects the shared responsibility of Customs and the trade community for achieving compliance. Together, Customs and the account: review the account's compliance; identify Customs and account issues; develop an action plan for improvement; and monitor performance and uniformity.

Account Profile - The aggregation of data displaying the history of an account's activity. An Account Profile is a compendium of raw data, history and other types of data regarding a specific business entity. The profile includes a thorough analysis of the compendium of data available from a variety of sources as well as findings, conclusions, and recommendations.

Compliance Assessment (CA) - A mechanism by which a Customs team evaluates a company's internal control systems to ensure that they promote the filing of transactions/declarations that are in compliance with laws and regulations. The CA is a mutually cooperative evaluation of an importer's system supporting its Customs related operations and includes testing import and financial transactions to: assess the compliance level in each trade area applicable to the importer; determine the adequacy of internal controls; and determine whether the importer's compliance rates are at acceptable levels. A CA uses customary audit techniques, including statistical testing, and will normally cover an importer's most recently completed fiscal year. If Customs determines that compliance is at acceptable levels in all areas tested, the audit process ends, an exit conference is held to discuss the results, and a compliance assessment report is issued.

Compliance Assessment Team (CAT) - An interdisciplinary team of Customs officers that performs the CA. The team includes a CAT Leader (lead auditor), auditors, Computer Audit Specialist, Import Specialist, International Trade Specialist, Account Manager (if one has been assigned) and other specialists as needed. An Industry Audit Specialist and an International Trade Manager provide advice to the team, as needed, and monitor the progress of the review.

Compliance Improvement Plan (CIP) - When not fully compliant, a company may be given the opportunity to prepare a CIP. This is a written plan of action to improve compliance. The objective of the plan is to develop and implement better procedures and internal controls and thereby prevent reoccurrence of the problems and ensure high levels of future compliance with Customs Regulations. A CIP contains corrective actions designed to bring the importer into conformity with Customs laws and regulations in any area of non-compliance found during the audit. After a Compliance Improvement Plan has been put into place, Customs will conduct follow-up verifications to determine whether or not improvements are occurring.

Compliance Measurement (CM) - A process of physical inspections of merchandise and/or Customs entry summary reviews to determine the rate of compliance via transactions. Compliance Measurement is a statistically valid method of determining compliance by means of examinations based upon the four-digit Harmonized Tariff Schedule (HTS) classifications. Results of Compliance Measurement enable Customs to assess performance relative to revenue collection and enforcement of Customs and related laws, by major industry areas and major importers. It provides the basis for working with importers in improving their compliance and in developing and implementing Customs' strategies to improve compliance.

Compliance Measurement Sampling Plan - A statistically valid sample selected for a measurement of compliance with United States trade law.

Compliance Risk Category - Previously known as "compliance buckets". Compliance Risk Categories provide a means of separating importers into groupings based upon the results of a Compliance Assessment. Category designations determine the number of exams an importer will be subject to (importers determined to be non-compliant will experience a higher number of examinations).

Customs Automated Port Profile System (CAPPS) - An automated tool that compares a port's compliance measurement results and national compliance measurement against results achieved through targeting. These results can be pulled up by various data elements including HTS, Importer, and MID.

Enforcement Evaluation Team - Customs established Enforcement Evaluation Teams to: make an early determination of the nature, extent and impact of instances of non-compliance; select the Customs response best suited to remedy the problem; and follow-up on that action to ensure the non-compliance problem is solved.

Enforced Compliance - Customs actions which may occur when companies are found to be in violation of Customs laws and have not exercised use of reasonable care.

Fiscal Year (FY) - Time frame used for most Customs activities (from October 1st to September 30th).

Harmonized Tariff Schedule (HTS) - Listing of all commodity codes and rates.

Importer Compliance Monitoring Program (ICMP) - A program which involves a systematic review of a company's import operations and includes both process and transactional reviews. Similar in concept to the Compliance Assessment program, reviews are conducted by the company in coordination and consultation with Customs.

Informed Compliance - A shared responsibility where-in the Customs Service effectively communicates its requirements to the trade, and the people and businesses subject to those requirements conduct their regulated activities in conformance with U.S. laws and regulations.

Integrated Trade Measurement System - An integrated system consisting of Compliance Measurement (CM), the measurement of individual transactions, and Compliance Assessment (CA), the post-transaction measurement of the compliance of an account.

Intellectual Property Rights (IPR) - A set of laws and regulations designed to protect copyrights, patents and trademarks.

Intervention - An initiative aimed at solving a problem or reducing the potential impact of a problem/problems.

MARC 2000 (Multiport Approach to Raise Compliance) - A program built to maximize Customs effect on industry compliance to reach Customs goal of 95% compliance in primary focus industries.

NAFTA Joint Verification Team (JVT) - A multi-disciplinary team comprised of the auditor JVT Coordinator, staff auditor, international trade specialist, import specialist (and other Customs employees as applicable). The JVT verifies an exporter's declaration on a certificate of origin that imported products are originating goods in accordance with the NAFTA rules of origin.

NAFTA Verification - A formal Customs inquiry into the origin of merchandise covered by a certificate of origin and entered as eligible for duty preference under the NAFTA. The inquiry may be conducted by letter, questionnaire, premises visit or any other method, which elicits information relevant to the origin of the merchandise from the exporter or producer of the merchandise, or from the producer of a material used in the production of such merchandise.

Primary Focus Industries (PFI) - Industries identified as vital to our economy and directly impacted by the level of compliance with trade laws. The current list is as follows: Agriculture, Automobiles/Automobile Parts, Communications, Critical Components, Footwear, Production Equipment, Steel, and Textiles/Wearing Apparel. These PFI's are determined by use of a number of factors, including strategic importance, international trade agreement concerns (including NAFTA, quotas, etc.), duty, public health and safety, Intellectual Property Rights, and Gross Domestic Product/economic impact. Potential additions to this listing comprise a "watch list" which requires additional monitoring and evaluation.

Risk - The degree of exposure to the chance of non-compliance which would result in loss or injury to the government, trade, industry, or the public.

Risk Management - A proactive management technique that identifies processes for controlling risk in trade compliance. It is accomplished through collecting data and information, analyzing and assessing risk, pre-scribing action, and tracking and reporting.

Risk Management Process - The Integration of systematic risk assessment into the strategic planning process in order that Customs may more effectively set compliance priorities and more efficiently allocate resources needed to evaluate and address identified areas of compliance vulnerability.

Self-Assessment - Customs encourages importers notified of a pending Compliance Assessment; to use the CA questionnaires and other information provided at the advance conference to conduct a self-assessment of their import operations. The self-assessment can help a company identify potential problem areas and, if appropriate, make a prior disclosure before the CA begins.

Selectivity Criteria - National commercial cargo selectivity criteria is created and maintained by the SOAS staff. Referrals for the creation of cargo selectivity criteria are received from numerous sources but primarily from local OAS units, Headquarters Office of Field Operations, Office of Regulations and Rulings, and the Office of Investigations.

Strategic Plan - A disciplined effort by Customs to produce fundamental decisions and actions that shape and guide what Customs is, what it does, and why it is done. Customs' Strategic Plan covers the five fiscal years forward from the fiscal year submitted and is updated at least every three years. The Strategic Plan includes a comprehensive mission statement; general goals and objectives for Customs' major functions; a summary of the resources, systems and processes that are critical to achieving these goals; a description of how the general goals and objectives will be achieved; a description of key external factors that could affect achievement of these general goals; a description of how program evaluations are used; and a schedule of future evaluations.

Strategic Planning Board (SPB) - An interdisciplinary management board that ensures the communication and implementation of critical policy determinations, goals, and priorities. The SPB reviews and approves: interventions; industry plans and profiles; changes in the primary focus industries; special projects; and company enforced compliance candidates. The SPB serves as an open forum for interdisciplinary issues and the coordination point for risk.

Trade Compliance - The process by which goods enter the United States in conformance with all U.S. rules and regulations.

Trade Compliance and Enforcement Plan - A published, integrated document, developed from the overall goals and objectives of the Strategic and Annual Plans. It states Customs' national commercial strategy and activities for the year and serves as the roadmap for trade enforcement efforts. It is a specific and detailed version of the trade compliance portion of the Annual Plan that identifies Customs' work to achieve our trade compliance strategic goals.

Trade Priority Issues - Important trade issues not identified by industries. The twelve priority issues are: Anti-dumping and Countervailing Duties; Intellectual Property Rights; Trade Agreements (focusing on NAFTA); Classification; Trade Statistics; Country-of-Origin Marking; Embargoes and Sanctions (includes forced labor); Public Health and Safety; Transshipment; Quota Evasion; Revenue, and Valuation.

Verification - An action taken on the part of a Customs officer to confirm compliance. Verifications consist of, but are not limited to, examinations, data reviews, laboratory analyses, compliance assessments, audits, investigations, and premises visits.

Appendix

1. EXAMPLES AND CASE STUDIES
2. RISK MANAGEMENT PROCESS MATRIX
3. POLICY ON MATERIALITY OF ERRORS IN COMPLIANCE ASSESSMENTS
4. SAMPLE ACCOUNT PROFILE
5. SAMPLE ACCOUNT ACTION PLAN
6. ENFORCE EVALUATION TEAM PROCESS

Appendix 1. EXAMPLES AND CASE STUDIES

1.1. Industry Analysis and Interventions

Steel

Steel importers frequently avoid paying duty on freight charges. Analysis by several organizations in Customs allowed us to focus in on this particular problem within the industry and the biggest violators. Because of informed compliance efforts in this area, Customs has collected \$1.5 million in additional duties and \$2.5 million in additional anti-dumping duties.

Critical Components - Fasteners

An issue existed in the classification of screws and bolts. Screws are frequently misclassified as bolts because of a lack of technical knowledge regarding their proper tariff classification or in an attempt to avoid higher duty rates. Two interventions were developed utilizing an informed compliance approach. Automobile manufacturers and other significant fastener importers with low screw-to-bolt import ratios were contacted and sent copies of an informed compliance publication to help them distinguish bolts from screws. The importers were asked to review their importations of fasteners to ensure the screws and bolts had been properly classified. Importers who refused to cooperate were dealt with using enforced compliance techniques. As a result of the interventions and the cooperation of many of the importers, over \$3,200,000 in lost revenue was recovered, with a potential \$1,000,000 more depending on the outcome of a case before the U.S. Court of International Trade.

Autos

Analysis suggested many large auto companies were using a basket provision (or “other” category) inappropriately. Many items being classified as “other” had specific designations in the tariff. The “8080” intervention was developed and Customs used informed compliance to address this problem with the auto industry. It was discovered that one company had classified more than 10,000 different items as “other”. After working extensively with Customs and its broker, the account reclassified all but 164 of the 10,000 items into specific categories.

Communications

Research by the Office of Strategic Trade showed that half of the cargo violations for one company were due to misdeliveries of freight at an air cargo facility. By working with OST and the account manager, the company was able to trace its problem to a process breakdown with the broker and freight forwarder. Solving this problem will cut the number of discrepancies for this importer in half. In addition, because this importer is so large, nationwide compliance in the affected tariff will improve by almost a percentage point.

Textile Transshipment

Since 1996, a textile transshipment team and a Textile Clearinghouse have been established. Extensive work has occurred with other countries. Results include:

- 64 Country A factories have been convicted of transshipment, and 15 have had their export licenses suspended by the Ministry of Trade.
- \$110 million worth of goods has been detained at Customs ports of entry because importers are unable to confirm that the goods originated in Country A.
- \$1.8 million in goods were charged back to the quota restraint levels for Country B (these goods were falsely declared Country A merchandise).
- \$3.2 million in goods were charged back to the quota restraint levels for Country C (these goods were transshipped to other countries prior to import).
- \$5.5 million in sheets claimed to be of Country D origin were traced to Country E.
- After a recent out-reach initiative, one U.S. firm canceled 30 contracts worth \$7 million with foreign vendors suspected of illegal transshipment.

1.2. Trend Analysis and Analytical Selectivity Program (TAP)

This automated tool allows Customs to analyze trends within a commodity or for a specific importer. The tool is operational in several ports. Based on the analysis of the information provided by this tool, informed or enforced compliance is used to address the problem. Revenue recovered to date is detailed below. Specific examples follow.

TAP Example 1: Misclassification, \$747,000 additional revenue, initiated fraud case

Issue

Misclassification of merchandise from electrical lighters under 9613.80 (3.9 percent duty) to pocket lighters under 9613.20 (9 percent duty) and possible “evasion” under new importer number and name. The misclassification originally detected from random CM.

Story

An importer’s shipment was selected for CM review/exam. Using TAP, an import specialist found that another importer, under a different name, was using the same manufacturer identification number. This importer had already been informed of the correct classification. An importer visit revealed that the two importers were owned and managed by the same person. TAP analysis showed trade patterns and defined the scope of significant noncompliance and a strong potential fraud case.

Bottom Line

By working a routine CM and doing roughly 2 minutes of TAP profile work and 1 minute referencing on the mainframe:

- Customs identified entries valued over \$12 million and recovered \$607,000 in duty.
- Another \$140,000 was collected because the broker paid the correct duty for merchandise correctly classified subsequently.
- A possible fraud case is developing over the issue of trying to avoid paying duties by changing names and importer numbers.

- Total imports of impacted merchandise reached over \$14 million between all companies and an investigation is underway.

TAP Example 2: Port initiates \$176 million fraud case

Issue

A company is suspected of misclassification and “port shopping” after receiving an adverse ruling from Customs.

Story

A company importing through Los Angeles was suspected of falsely claiming preferential trade privileges. TAP analysis showed that while this importer shipped equally into two ports - Los Angeles and Dallas - the commodity in question was shipped primarily into Los Angeles. Coordination between the ports revealed that Dallas had provided the importer with a Headquarters’ ruling denying its preferential trade privilege request. After this ruling the importer simply switched ports. At an importer visit, the company’s attorney admitted that the importer intentionally shifted its importations to the port of LA because it had been denied the privilege in Dallas.

Bottom Line

- A \$176 million fraud case was initiated
- TAP research identified other companies importing similar merchandise by identifying who used the same manufacturers
- As a result of additional action with these importers, Customs:
 - received a voluntary tender of \$675,199 from one importer
 - issued a combined rate advance close to \$1 million for another importer
 - is currently pursuing other companies and millions of dollars in potentially lost revenue

TAP Example 3: Potential “port shopping” to evade dumping duties

Issue

Importer “port shopping” to avoid anti-dumping duty.

Story

An import specialist suspected of non-payment of anti-dumping duty. TAP analysis showed that the importer was the only importer that brought this commodity into the Port of Seattle. Further TAP analysis showed that the company imported the same commodity into Chicago and paid the anti-dumping duty there. The company had recently shifted its imports of this commodity from Chicago to Seattle.

Bottom Line

Potential revenue recovered: \$254,860 in anti-dumping duties.

1.3. Compliance Assessments

Overall Success

At the end of Fiscal Year 1998, nearly 140 CA's were complete and more than 260 were planned or in progress. This represents 52 percent of the value of all PFI imports. Results include more than \$40 million in prior disclosures and 29 referrals for investigation. Specific examples follow.

Compliance Assessment #1

An assessment of a large communications importer was scheduled as part of the CA plan for FY 1997. As part of the research and evaluation preparation preceding the CA, Customs developed an importer profile of the company. The profile indicated a potential problem with the special trade agreement importations. The CA team, consisting of auditors and import specialists, commenced the CA in August of 1997.

In drawing the routine sample from the importer's records, 25 transactions of the sample of 220 drawn were special trade agreement entries. In attempting to verify these transactions, repeated requests were made for records to substantiate the claim. After several failed attempts, the importer was not able to produce sufficient documentation to satisfy the CA team that the special trade agreement claims were valid.

After several unsuccessful attempts to substantiate the claims, the company filed a prior disclosure indicating inability to adequately support the claims. The port rejected the prior disclosure as incomplete. The Office of Investigations was notified and a formal investigation was opened.

The investigation showed that in 1995, a classification protest was filed with Customs by the company claiming the merchandise was duty free. The protest is still under consideration. Aside from the classification protest, the issue remains that the entries were filed claiming a special trade agreement deduction which is now being acknowledged as incorrect by the company. U.S. Customs has previously issued rulings relative to this merchandise to other industries which support the classification and found the merchandise to be dutiable.

A meeting was held between Customs and company representatives where the company acknowledged its inability to substantiate its claims. Customs expects to issue a demand for the loss of revenue of approximately \$17 million on the liquidated entries once the investigation is complete.

Compliance Assessment #2

An assessment was scheduled as part of the CA plan for FY 1996. In drawing the routine sample from the importer's records, Customs identified a single classification error in the sample of 220 transactions.

Subsequent CA team review revealed that importer's misclassification was a systemic error. The CA team determined that the company owed an additional \$210,778 in duties.

During the course of the subsequent review, evidence was obtained which indicated that the importer was aware of its misclassification. In addition, it was shown that—for a brief period in 1995—it had used the correct classification before reverting back to its incorrect classification.

As a result, the Office of Investigations opened a formal investigation.

OI conducted interviews and attributed the cause of the importer's misclassification to a misinterpretation by the company's Import/Export Compliance Office, which believed that the rulings applied only to certain merchandise. As a result, charges against the company were not filed, but Customs held the importer responsible for the classification of the merchandise from August 1995 forward. This resulted in duties and interest owed of \$50,719. The importer tendered the monies owed and developed a Compliance Improvement Plan (CIP) to correct the classification deficiencies noted in its internal controls.

In 1998, Customs reviewed the CIP implemented by the importer. The follow-up review indicated that the company had successfully implemented the CIP for the proper classification of imported merchandise.

Compliance Assessment #3

An importer undergoing a CA also began a self-assessment. This self-assessment entailed the importer conducting an in-depth compliance review on its own, using a sample selected by U.S. Customs. The importer chose to conduct the self-assessment because by discovering problems on its own and submitting payments for revenue discrepancies found prior to Customs review, the importer could preempt serious penalties and investigations.

As part of the self-assessment, the importer discovered problems in the areas of classification, quantity, anti-dumping duties, record keeping, and valuation. As a result of the self-assessment and CA, the company filed 19 prior disclosures. The revenue tendered for nine of the disclosures totals \$4.3 million. Revenue quantifications are still underway for the ten remaining disclosures. The company has developed a Compliance Improvement Plan and is now implementing remedies for its compliance problems. Its improvements will be validated during a follow-up verification with Customs.

1.4. Account Management

Account #1

A medium-sized company was selected as an account to be managed by a team of Customs personnel at a port. The company imported merchandise through 15 ports across the country and felt very comfortable with its internal control systems.

The Customs team reviewed the company's importing practices and found serious problems with the systems the company used to identify anti-dumping cases. Because of inadequacies in its internal systems, the importer had lost the opportunity to regain more than \$240,000 in anti-dumping duties. The cases had been closed for several years, and it had been determined that the anti-dumping duties could be refunded. However, the importer never filed for a refund and by the time the Customs team discovered the problem, it was too late to do so. The importer fixed its internal systems to ensure similar errors did not occur in the future.

In addition, the Customs team noticed that the importer paid its duties by express mailing checks each day to the 15 ports. The team introduced the importer to Customs automated payment system, saving the company and its sister corporation \$40,000 a year.

Account #2

To test the concept of account management, a port team selected an importer thought to have very few compliance problems. The company had imported merchandise through the port for several years. Customs had not conducted any detailed reviews of the company's importations in some time, but the team felt comfortable with the account's importing history.

After conducting a thorough analysis of the importer's systems, the Customs team was shocked. More than 30 per-cent of the goods the company imported was mis-classified. One misclassification alone led to a revenue recovery of \$100,000. The team and the importer worked together to develop an action plan to address the compliance problems, and the importer is now implementing the remedies.

Account #3

A Customs account team notified an importer that it had been selected as a Customs account. The team explained to the importer what the account management program entailed and explained the concept of "shared responsibility." According to U.S. laws, it is Customs responsibility to ensure its trade regulations are publicized and easily understood. It is the importer's responsibility to ensure its merchandise is classified correctly and does not violate any regulations.

The company was not aware of the extent of its importing responsibility and requested additional information. Customs provided the importer with a CD-ROM containing three years worth of import data for the company and several Customs publications related to the type of merchandise imported by the company.

After reviewing the data, and before Customs began its own review, the importer requested a meeting with the team. At the meeting, the company acknowledged that they had identified several problems with their imports and submitted a prior disclosure for \$1.1 million. The Customs team is currently reviewing the disclosure and working with the account to develop an action plan to address the systemic compliance problems.

Appendix 2. RISK MANAGEMENT PROCESS MATRIX

Several Customs processes are interwoven with the overall Risk Management Process. The following matrix illustrates the links and interdependencies.

Collect Data and Information	Analyze and Assess Risk	Prescribe Action	Track and Report
Collect all of the data and obtain all of the information on any potential risk in the trade compliance process.	Perform further analysis to determine the likelihood of non-compliance and uncover any mitigating factors.	Determine the root cause of non-compliance, acquire the necessary resources, and implement action to alleviate the risk.	Assign ownership for the action, track the progress, and feed the results back into the Risk Management Process.
Compliance Measurement	Automated Tools	Informed Compliance	Trade Compliance and Enforcement Plan
Compliance Assessment	Significance/Materiality Definitions	Enforced Compliance	Report to Congress on Trade Compliance
Criteria and Exams	Compliance Risk Categories	Enforcement Evaluation Team	Monitoring Account
Account Management	Enforcement Evaluation Team Impact Levels	Compliance Improvement and Account Action Plans	Follow-up Verifications
	Account Evaluation		

Appendix 3. POLICY ON MATERIALITY OF ERRORS FOUND IN COMPLIANCE ASSESSMENTS

“Materiality” as used in this document is different than, and distinct from, the word “materiality” as used in 19 U.S.C.1592.

The U.S. Customs Service, Office of Strategic Trade, Regulatory Audit Division, has established its policy for assessing the results of Compliance Assessments (CA’s) or reporting the materiality of discrepancies found in classification, quantity, transaction value, and conditional checks. The attached matrix provides an overview of the materiality policy for the tested areas. The policy is intended to accomplish three important goals:

- Improve consistency in the compliance testing of importer transactions, evaluation of test results, and recommended corrective action.
- Provide a “letter of the law” (LOL) compliance rate allowing comparison between compliance assessment and compliance measurement results for classification, quantity, and reported value.
- Establish a uniform system of reporting compliance assessment results, which complies with Generally Accepted Government Auditing Standards.

Background: In Fiscal Year 1996, Compliance Assessment (CA) teams, composed of members from several Customs disciplines and led by Regulatory auditors, began conducting CA’s of major importers. The CA teams used statistical testing of transactions to determine if importers had internal control systems that produced accurate and complete Customs information. The CA teams computed a compliance rate for each of the “common check” trade areas, and also tested other “conditional” trade areas, if they were relevant to the importer under review. The compliance rates measured the percentage of time sampled transactions were correct. If a compliance rate was below 95 percent in any trade area, the CA team determined the cause and effect of the non-compliance and recommended corrective action. The compliance rates are used by the CA team as a basis for its recommendation of a “compliance risk category” in the CA audit report.

Both CA teams and importers were concerned because some of the instances of non-compliance found during the assessments were minor discrepancies that resulted in low compliance rates but did not accurately reflect the importer’s overall compliance with Customs regulations. There were also questions about how minor discrepancies should be addressed in the CA audit report. Since Customs must adhere to Generally Accepted Government Auditing Standards, any consideration of materiality of audit results or reporting had to comply with those standards.

To address these concerns, representatives from Customs Office of Strategic Trade, Office of Field Operations, and importers from several different industries, formed a joint task force to resolve differences on the issues and develop a policy on the materiality of audit findings. The following procedures are the result of the joint effort of Customs and trade representatives.

Procedures: In accordance with Generally Accepted Government Auditing Standards, Customs will report all instances of non-compliance with laws and regulations to the auditee and will also place its findings, taking materiality into consideration, into perspective in the audit report. A LOL compliance rate will be computed for classification, quantity, reported

transaction value, record keeping, and certain “conditional check” trade areas (special trade pro-grams and trade focus areas).

If the LOL compliance rate is at least 95 percent and internal controls are documented, the CA audit report should recommend the company be considered low risk in the respective trade area. If the LOL compliance rate is at least 95 percent, but internal controls are not documented, the report should recommend the company be considered moderate risk in the respective trade area. If the LOL compliance rate is below the acceptable rate of 95 percent in these areas, a materiality compliance rate will be computed. CA audit reports will include both LOL compliance rates and materiality compliance rates. The materiality compliance rate will be the basis for the compliance risk category recommended in the audit report.

Details for Each Trade Area

CLASSIFICATION

LOL Compliance Rate

The CA team import specialist reviews the classification of each item in the sample and compares it to the classification entered on the Customs Form (CF) 7501.

Any discrepancy between the tenth digit tariff number determined to be correct by the CA team import specialist and the tariff number entered on the CF 7501 is counted as an error.

Sample data is entered into an electronic sampling program which projects a statistically valid error rate (includes allowance for sampling error). The LOL compliance rate is 100 percent minus the projected error rate. The LOL compliance rate states the percentage of sampled items that are correctly classified to the tenth tariff digit.

If the LOL compliance rate is below 95 percent, a materiality compliance rate will be computed to put the significance of the errors in perspective.

Materiality Compliance Rate

The CA team import specialist determines, for each discrepancy, the tariff number digit where the classification error occurred. If the discrepancy occurred at the ninth or tenth digit, the CA team import specialist determines if the discrepancy resulted in a loss of revenue or affected admissibility.

Any discrepancies identified in digits one through eight of the entered tariff classification plus any discrepancies in the ninth or tenth digit that resulted in a loss of revenue or affected admissibility are counted as “material” errors.

The CA team enters only the “material” errors in the electronic sampling program to determine the projected materiality error rate (including sampling error). The materiality compliance rate is 100 percent minus the projected materiality error rate. The materiality compliance rate states the percentage of sampled items that were correctly classified to the eighth tariff digit and had no errors at the ninth or tenth digit that caused a loss of revenue or affected admissibility.

If the materiality compliance rate is 95 percent or above, no Compliance Improvement Plan (CIP) is required, just a recommendation that the importer strive to assure reported classifications are correct to the tenth tariff digit. If the materiality compliance rate is at least

95 percent and internal controls are documented, the CA audit report should recommend the company be considered low risk for classification noncompliance.

If the materiality compliance rate is at least 95 percent, but internal controls are not documented, the report should recommend the company be considered moderate risk for classification non-compliance. If the materiality compliance rate in classification is below 95 percent, the company will be required to submit a CIP and the report will recommend the company receive the level of cargo examinations for high risk importers.

QUANTITY

LOL Compliance Rate

The CA team reviews the quantity recorded in company records (inventory, receiving, etc.) and compares that quantity to the number recorded on the CF 7501 and the invoice. In some cases, the tariff does not require a unit quantity on the CF 7501, so the quantity in company records should be compared to quantities on the commercial invoice instead.

Any discrepancy, either over or short, between the quantity entered in company records and the quantity on the CF 7501, or invoice, is counted as an error. In some instances, importers have documented agreements with the ports on how to handle small quantity differences identified after entry summary. The CA team should consider these agreements when deciding if a discrepancy is to be counted as an error.

Sample data is entered into an electronic sampling program which projects a statistically valid error rate (includes allowance for sampling error). The LOL compliance rate is 100 percent minus the projected error rate. The LOL compliance rate states the percentage of items tested that had accurate entered quantities. If the LOL compliance rate is below 95 percent, a materiality compliance rate will be computed to put the significance of the errors in perspective and determine the government risk and the associated level of cargo examinations to recommend in the audit report.

Materiality Compliance Rate

To put the errors in perspective, the dollar value of each error (based on discrepant units times the value per unit), both over- and under-declared, is added to determine the absolute total dollar value of the quantity errors. The total value of the discrepant quantities is divided by the total reported transaction value of the sample to compute the materiality error rate. For example, the total reported transaction value of the 100 sample line items is \$3 million. There are 140 discrepant units valued at \$100 each (\$14,000). The materiality error rate is .47 percent ($\$14,000/3,000,000 = .47$ percent). The materiality compliance rate is 99.53 percent (100 percent - .47 per-cent = 99.53 percent). This method uses a simple ratio, with no sampling error added. The materiality compliance rate measures the value of the errors in relation to the total reported transaction value of the quantities tested.

Experience has shown that CA's completed on importers using reasonable care, the materiality compliance rate is at least 99.5 percent. Therefore, if the materiality compliance rate is 99.5 percent or above, no CIP is required, just a recommendation that the importer strive to assure accurate quantities are reported. If the materiality compliance rate is at least 99.5 percent, and internal controls are documented, the company should be considered low risk for non-compliance in entered quantities.

If the materiality compliance rate is at least 99.5 percent, but internal controls are not documented, the report should recommend the company be considered moderate risk for non-compliance in entered quantities.

If the materiality compliance rate in quantity is below 99.5 percent, the company will be required to submit a CIP and the report will recommend the company receive the level of cargo examinations for high risk importers.

REPORTED TRANSACTION VALUE

LOL Compliance Rate

The CA team reviews the reported transaction value recorded in company records (payments, purchases, etc.) and compares that reported transaction value to the amount recorded in the CF 7501.

Any discrepancy, either over- or under-declared, between the reported transaction value entered in company records and the value reported on the CF 7501, is counted as an error. As in the case of quantity, importers may have documented agreements with the ports on how to handle small value differences found after filing the entry summary. The CA team should consider these agreements when deciding if a discrepancy is to be counted as an error.

Sample data is entered into an electronic sampling program which projects a statistically valid error rate (includes allowance for sampling error). The LOL compliance rate is 100 percent minus the projected error rate. The rate measures the percentage of the items tested that had accurate entered reported transaction values.

If the LOL compliance rate is below 95 percent, a materiality compliance rate will be computed to put the significance of the errors in perspective and determine the government risk and the associated level of cargo examinations to recommend in the audit report.

Materiality Compliance Rate

To put the errors in perspective, the reported transaction value of each discrepancy, both over- and under-declared, is added to determine the absolute value of the discrepancies. The value of the discrepancies is divided by the total value of the sample to compute the materiality error rate. This method uses a simple ratio, with no sampling error added. The materiality compliance rate measures the value of the errors in relation to the total value tested.

For example, the total value of the 100 sample items in the sample is \$5 million. Discrepancies in value total \$33,000. The materiality error rate is .66 percent ($\$33,000/\$5,000,000 = .66$ percent). The materiality compliance rate is 99.34 percent (100 percent - .66 percent = 99.34 percent).

If the materiality compliance rate is 99.5 percent or above, and internal controls are good, the company should be considered low risk for non-compliance in reporting accurate transaction value. No CIP is required, just a recommendation that the importer strive to assure accurate transaction values are reported.

If the materiality compliance rate is at least 99.5 percent, but internal controls are not documented, the report should recommend the company be considered moderate risk for non-compliance in entered value.

If the materiality compliance rate in reported transaction value is below 99.5 percent, the company should be required to submit a CIP and the report should recommend the company receive the level of cargo examinations for high risk importers.

UNREPORTED TRANSACTION VALUE

There are no compliance rates computed for unreported transaction value, either LOL or materiality. The risk level for the importer is determined based on the \$100,000 threshold stated in the audit program. If unreported transaction value equal to or more than \$100,000 is found during any part of the CA (including projected amounts), the company should be required to submit a CIP and the report should recommend the company receive the level of cargo examinations for high risk importers.

If less than \$100,000 in unreported transaction value is found during any part of the CA, and if the company's has documented internal control procedures for this area, the company should be considered low risk for the trade area. If less than \$100,000 in unreported transaction value is found, but the company does not have documented internal control procedures, the company should be considered moderate risk for the trade area.

COMPUTED VALUE

A materiality compliance rate is not computed for this area. The importer's risk level is based on the LOL compliance rate as this rate already takes into account the dollar value of errors. The LOL rate for computed value equals the value or duty difference (error) per audit of the cost sub-mission, divided by the total value or duty reported by the company in the cost submission.

RECORDKEEPING

No materiality compliance rate will be computed for recordkeeping because materiality is considered in the selection of records or data to test.

CONDITIONAL CHECKS

Materiality Compliance Rate

With the exception of transshipment, the computation of materiality compliance rates for conditional check areas follows the same guideline as quantity and reported transaction value – i.e. the total absolute value of the errors is divided by the total value of the sample to compute the materiality error rate. The materiality compliance rate is 100 percent minus the materiality error rate.

The value of an individual error may be the total value of the sample item (e.g., if requirements for special treatment are not met) or part of the value of the sample item (e.g., if the incorrect value was claimed for special treatment). As an illustration, the value of an error in review of HTSUS 9802.00.80 would be the total reported value of the sample item if foreign fabrication was required before assembly (i.e. HTSUS 9802.00.80 treatment requirements were not met). However, the value of an error in the same review would be

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only part of the reported value of the sample item if one component of the imported article (made up of several components) was determined to be of foreign origin. In this case, the value of the error would be only the value of the foreign component (not the total reported value of the sample item).

If the materiality compliance rate is 99.5 percent or above, no CIP is required, just a recommendation that the importer strive to assure accurate reporting. If the materiality compliance rate is at least 99.5 percent, and internal controls are documented, the company should be considered low risk for non-compliance. If the materiality compliance rate is at least 99.5 percent, but internal controls are not documented, the report should recommend the company be considered moderate risk for non-compliance.

If the materiality compliance rate is below 99.5 percent, the company will be required to submit a CIP and the report will recommend the company receive the level of cargo examinations for high-risk importers.

For transshipment, compliance rates (LOL and materiality) are not computed. If errors are identified in tests for Transshipment, further action will depend on the individual circumstances (refer to the Technical Guide).

EFFECTIVE DATE: This policy is effective for all compliance Assessments in process as of or started after January 1, 1999.

QUESTIONS: Any questions relating to this policy may be directed to Carrolyn McDaniel at (206) 553-1336 or to Thomas Jesukiewicz at (562) 980-3220.

Appendix 4. SAMPLE ACCOUNT PROFILE

PREPARED BY HENRIETTA FORD
(310) 980-3119, x444
LOS ANGELES STRATEGIC TRADE CENTER
JANUARY 1997

**ALLIED AUTO PARTS, Inc.
Lansing, Michigan**

FOR US CUSTOMS INTERNAL USE ONLY

Warning: Criminal Penalties

This document contains trade secrets and commercial and financial information relating to the confidential business of private parties. The Trade Secrets Act, (18 U.S.C. 1905), provides penalties for disclosure of such information. Federal employees who violate this act and make wrongful disclosures of confidential commercial information may be subject to a personal fine of up to \$1,000.00, imprisonment for not more than one year, or both, and shall be removed from employment. Also, improper disclosure of certain information contained in this document could constitute a violation of the Privacy Act (5 U.S.C. 552a) and violators could be subject to a fine of not more than \$5,000.00.

INTRODUCTION

Allied Auto Parts, Inc.'s business year selected for assessment and profile is January 1 through December 31, 1996. This profile also notes any trends on selected data for the company's two previous business years. Data was obtained from ABI line items for importer of record number 12-3456789-00, and comprises 99.6% of the total entered value of all importations.

[**SAMPLE ACCOUNT PROFILE**]

ACCOUNT INFORMATION

Contacts: Valerie Powers, Customs Administrator
1515 Hanseatic Lane Lansing, Michigan 33145
(313) 456-0000 x123
Email address: valerie@ottos.com
Internet address: Allied.com

Point of contact for all Customs records and samples.

Location of Records: Entry records: Allied Sales Office, 123 Auto Lane, Detroit, MI 48105
Financial records: Corporate HQ, Lansing, MI
Merchandise: Allied Distribution Center, 1550 Industrial Blvd., Detroit, MI 48117

Date of last Customs Audit: n/a

Identifying Numbers: Profiled IR#: 12-3456789-OP
Other IR#s: 12-3456789-XX. Last used in 1992 for drawback entries only.
Dun and Bradstreet: 10202
Other identifiers: N/A

Corporate History, Organization and Financial Data:

Standard and Poor's and Dun & Bradstreet reports provided the following information on Allied Auto Parts. The Michigan corporate file # is 2357966. The business was started in 1975 by Stuart Powers. Its initial business was importation and sales of Country X's auto parts but later expanded to include domestic manufacturing of OEM and after-market parts for imported Country X's automobiles. 100% of capital stock is owned by outside investors. Starting capital is two million dollars. Credit rating is AAA. The annual report shows rapid expansion of the business territory in the last two years to include sales in all of the continental United States.

The President and Chief Executive Officer of Allied Auto Parts from 1980 to present is Stuart Powers. Vice President is Emily Powers. Secretary-Treasurer is Benjamin Powers. Allied Auto Parts has approximately 1400 employees, 900 in corporate headquarters and the manufacturing center in Lansing, with another 300 in the Detroit distribution center. The remaining personnel are employed in various sales offices across the United States. Allied legal representation is provided by in-house attorneys. There is one subsidiary in Country X. Its principal business is automobile rentals to American tourists. Allied Auto Parts has sales offices in Los Angeles, Detroit, and Newark, New Jersey. Allied's fiscal (business) year is January 1 through December 31st.

Customs Program Participation: Allied Auto Parts participates in the electronic invoicing process.

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[SAMPLE ACCOUNT PROFILE]

IMPORT ACTIVITY

Bond Information: Allied Auto Parts is covered by a \$100,000 continuous bond (#13579), effective January 1996. The surety is No-Fault Insurance Company. The bond appears adequate in that it is more than 10% of the previous year's duties and fees.

FY 1996 Trade Statistics

Rank in top 1,000: ranks #889.

Rank in Auto Parts PFI: ranks #166.

		% of Entered Value	Cumulative Percentage
Major HTSs:	8708.99.8080 (other auto parts)	21%	21%
	8708.29.0010 (body stampings)	18%	39%
	8708.21.0000 (seat belts)	11%	50%
	8482.10.5080 (bb w/integral shaft)	10%	60%
	8482.10.1050 (crankshafts, other)	10%	70%
	7818.15.2090 (other bolts)	9%	79%
	7315.11.0010 (articulated roller chain)	8%	87%
Ports of Entry:	Newark, NJ	62%	62%
	Detroit, MI	34%	96%
	JFK Airport	4%	100%
Brokers Utilized:	Quick Release, Inc., Newark and JFK	66%	66%
	Midwestern Forwarders, Detroit	34%	100%
Entry Types:	01 - consumption	88%	88%
	03 - dumping	11%	99%
	21 - warehouse	1%	100%

Totals and %s of entries filed remotely: N/A

Entries with Liquidations Extended: 2 entries in Newark, 1996, HC 086 (import specialist visits)

Special Trade Programs: GSP (Country Z) 6% of total entered value, 42% of Country Z's entered value

Countries of Origin:	Country X	64%	64%
	Country Z	22%	86%
	Country W	8%	94%
	All others, less than 1% each		
Countries of Export:	Country X	72%	72%
	Country Z	22%	94%
	All others, less than 1% each		
Major Mfr Ids:	DEDEUAUT644HAM (Country X)	31%	31%
	DEZOO134BER (Country X)	29%	60%
	BRMARPOL444RIO (Country Z)	18%	78%
	DEHOCQUA9009BRE (Country X)	10%	88%
	FRPOULES101MAR (Country W)	8%	96%
	All others, less than 1% each		

[SAMPLE ACCOUNT PROFILE]

A comparison of information from 1996 imports with the two previous years shows some changes worth noting. Country Z emerged as a country of origin in 1995, with GSP from Country Z as a new trade program in that year. The total value of importations showed a 6% increase from 1994 to 1995 and an 8% increase from 1995 to 1996. The broker-age firm Speedy Inc. was dropped as the entry filer in late 1995. Tariff utilization remained largely unchanged, with the exception that the percentage of merchandise classified in the basket provision increased 11% from 1995 to 1996. This may be due to the selection of a new broker, as entries filed by Quick Release showed a 43% ratio of basket provision to total auto parts as compared to a 16% ratio for entries filed by Speedy, Inc. Also, dumping duties paid increased by 75% from 1995 to 1996. See “classification” and “anti-dumping” sections below for further information.

Trade Issues - Company and Industry Analysis

Anti-dumping Duties - There is no history of cargo exam or entry summary anti-dumping discrepancies for this importer. The high number (73) of cargo exams for this importer in 1994 occurred because of “Operation Unbearable”, a bearings enforcement blitz. Although the blitz did not uncover cargo discrepancies, entry review revealed discrepancies and bills were sent to the importer. The CST worked with the importer to obtain the correct assignment of anti-dumping case numbers for bearing importations. The amount of anti-dumping duties paid in 1996 increased by 74% from the 1995 amount due to these improvements.

Allied’s imports articulated link roller chain from Country Y and Country X under tariff # 7315110050. Country Y’s roller chain is subject to anti-dumping although the Country X’s product is not. All of 1996 Country Y’s importations of merchandise classified as roller chain were declared as subject to anti-dumping. 93.87% of 1996 entered value under heading 8482 was declared subject to anti-dumping duties. This high percentage would tend to indicate a high level of compliance.

No importations under heading 8483 were declared subject to anti-dumping in 1996. Tariff numbers under heading 8483 may be subject to bearing anti-dumping cases and crankshaft anti-dumping cases. Comparison with heading 8483 imports by other similar Country X’s parts importers indicate that nearly all paid anti-dumping for bearings and/or crankshafts on importations under this heading during 1996. This indicates a potential for anti-dumping non-compliance for merchandise classified under this heading.

Another concern is whether the correct anti-dumping cases have been claimed, as the claimed cases tend to be those with the lower margins. Although this is not necessarily an indication of non-compliance, it should be kept in mind during the anti-dumping portion of the assessment.

Value: Undeclared assists have been a historical problem in the automotive industry, particularly in the area of body stampings, which comprise 18% of Allied’s imports by value.

[SAMPLE ACCOUNT PROFILE]

Classification: Classification of the auto part “basket provision”, 8708.99.8080, has been particularly troublesome in the automotive industry over the recent past. Since Allied has a high utilization of this tariff classification (33% of all auto parts), a separate sample of this tariff number is recommended.

The screws vs. bolts classification and revenue issues also needs to be examined. The bolts to screws ratio by value is 85% to 15%, a very high ratio indicating a potential loss of revenue from screws incorrectly classified as bolts. The Customs Service has determined that a rough average ratio of bolts to screws in the automotive industry is 5% bolts to 95% screws. The value of the “other fasteners” category is also quite large and composed chiefly of merchandise entered at the “free” rate of duty. Misclassification and revenue loss may be occurring here as well.

Special Trade Programs - Allied claimed importations from Country Z valued at \$1.2 million as eligible for Generalized System of Preferences in 1996. Research reveals that over one quarter of the Country Z’s claims (on a total of 137 entry summaries) were for merchandise classified as 8409.91.9290 (engine parts, other, for marine propulsion engines), designated as free from all GSP beneficiary developing countries. However, entry summary review results for entry #H02-123789 filed in Newark, NJ, noted that this merchandise should have been classified as 8409.91.5080 (engine parts, other, for automobiles) at a three percent duty rate. (Country Z’s merchandise classified under this subheading is ineligible for GSP). It is probable that other entries of this merchandise are similarly ineligible for GSP treatment. Classifications on the other 136 entries should be reviewed during the compliance assessment.

Chapters 98 and 99 - Only three entries with a total value of \$ 1,386.00 were made under these provisions. The tariff number in each case was 9801001025 (U. S. goods returned for repair, alteration, or processing; to be re-exported.)

Intellectual Property Rights - Allied does not have any intellectual property recordings with U.S. Customs. However, according to one SIR, Allied domestically manufactures replacement parts for several brand names recorded with Customs, but the agreement does not authorize foreign parts sourcing. CST 123 in Detroit has current copies of licensing agreements on file. There are no exclusion orders which would impact on the imported merchandise.

TARGETING ACTIVITY

Cargo Examination History: During the 1994 - 1996 period there were 86 exams (including six compliance measurement exams) with one marking and four classification discrepancies on four discrepant lines (95% of examined lines were non-discrepant). Complete information on all examination results is available.

[SAMPLE ACCOUNT PROFILE]

Entry Summary History: Of 1213 entries filed in 1996, 1110 (92%) were bypassed. Of the 103 reviewed, fourteen entry summary discrepancies were discovered on nine entry summaries over the 1994-1996 period. There were ten classification discrepancies and four quantity discrepancies. However, one of the classification discrepancies was for merchandise that, if classified correctly, would no longer be eligible for GSP treatment (see “Special Trade Programs”, above). Six discrepancies involved merchandise misclassified under “8080”. No discrepancies involved anti-dumping or other crucial issues, other than those previously noted. There were no entry summary compliance measurements.

VERIFY ACTIVITY

There have been no lab reports, binding rulings, CF 6431s, PIRPs, internal advice or interventions for this importer. The CSTs in ports handling Otto’s importations state that they have no records of CF 28s or CF 29s for this importer. CST 123 in Detroit has provided a brief Significant Activity Report and a more extensive SIR by the CST 137 (bearings) dated January 1994. The SIRs contained no significant findings but indicated that the importer had only a cursory understanding of classification issues dealing with bearings. Allied, along with their major broker, compiled a “Product and General Information Handbook” in February 1996 that describes their procedures for classification. The handbook also contains a parts database, manufacturers’ part codes, part descriptions, a glossary of terms and other related material. This information is available to the CAT as needed.

REVENUE ACTIVITY

Bill and refund activity has been minimal. There were six refunds totaling \$1,201.95 and five collections totaling \$392.78 in the 1994-1996 time period. There was one prior disclosure in 1992 in the Port of Newark, NJ, , with a tender of \$2,344 for misclassification of windshield wiper blades for a six-month period. The disclosure was accepted as presented.

ENFORCEMENT ACTIVITY

Office of Investigations checks yielded negative results with respect to current or past cases. There are no known current COMOIRs related to this importer. There are three liquidated damages on record for this importer for late filing of entry summaries. A total of \$75.00 was collected. This importer filed one protest, which was approved, involving a clerical error on the exchange rate used on one entry summary.

CONCLUSIONS

Allied imports auto parts and accessories primarily for aftermarket sales. Imports by country of origin, tariff number, filer, port and other criteria have been largely consistent over the 1994-1996 period. The two most significant changes that have occurred over the past three years are that the amount of anti-dumping duties paid increased by 74% from 1995 to 1996, and the 11% increase in basket provision usage.

[SAMPLE ACCOUNT PROFILE]

There are several areas where noncompliance may exist and which the Compliance Assessment Team can address, by the use of stratified sampling or by a tailored approach to the review of records. First, as outlined in the “Trade Issues” section, merchandise claimed to be subject to GSP may be misclassified. If correctly classified, it may no longer be eligible for GSP treatment. Those classification determinations need to be made. Second, none of Allied’s importations under tariff heading 8483 were declared as subject to anti-dumping. In addition, it is possible that some bearing importations under heading 8482 may be assigned an incorrect case number. Third, Allied’s fasteners importations may be misclassified. Lastly, the high (and increasing) level of basket provision usage combined with the associated error rate in reviewed entry summaries makes this a prime area of concern.

Appendix 5. SAMPLE ACCOUNT ACTION PLAN

**SVENSKA INDUSTRIES
JUNE 1997 - MAY 1998**

POINTS OF CONTACT:

Svenska Industries Karalina Backstrom, (555) 555-0000
Supervisor, Traffic Department

U.S. Customs S. A. Mann, (555) 123-4567
Port Account Team Lead
City, State

Other Port Account Team members:
Anna Jones (555) 123-4568
Stella Baker, (555) 123-4569

Plan Date June 1, 1997

Distribution NASC - Peg Martin
NIS - Bob Schwartz
ITM (HQ) - Jim Shaw
CAT Leader - Terry Allen
Director, SOAS
Process Owners at Major Entry Ports:
Los Angeles, CA
New Orleans, LA
Seattle, WA

ACCOUNT ACTION PLAN

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CHECKLIST

Those Items checked “YES” are included in this Plan. Those checked “NO/NA” are not included, and the reason why is briefly stated below. Each item must be checked with either a ‘YES’ or a ‘NO/NA’.

1. Compliance Items: Yes NO/NA Resolution Date

- A. Classification -----
- B. Valuation -----
- C. Quota/Visa -----
- D. ADD/CVD -----
- E. Special Trade Programs -----
- F. Admissibility -----
- G. Invoice Requirements -----
- H. OGA -----
- I. Internal Controls -----
- J. Quantity -----

2. Business Items:

- A. ABI -----
- B. ACH -----
- C. Remote Filing -----
- D. Reconciliation -----
- E. Manifests -----
- F. Entry Filing Method -----
- (CF 3461, CF 7501, Paperless, etc.)
- G. Other automated programs -----
- (Drawback, Protest, Etc.)
- H. Efficiency Issues -----
- I. Other* -----

3. Items Requested by Account:

- A. Clarification of Marking Requirements -----

Reasons for NOT including above checked items:

Item:	Reason:
Quota, AD/CVD, Special Trade Programs:	Not applicable to this industry/account
Admissibility, OGA, Quantity:	No problems identified.
Business Items:	None identified to date.

ACCOUNT BACKGROUND AND STRUCTURE :According to 1996 import data, Svenska Industries ranked 1999 by value for communications, a Primary Focus Industry. Established in 1980, the account is known as a major importer and distributor of European cell phone parts and accessories. In 1996, importations were valued at over \$99 million and the account paid over \$9 million in duty.

Svenska Industries is a privately held U.S. corporation based in Portland, OR. It has a subsidiary in Portland, Maine which handles marketing and product distribution on the East Coast. All shipments are imported through the ports of Los Angeles, New Orleans, and Seattle. Svenska Industries' Compliance Measurement rate is eighty two percent.

All the import and financial documents are located at the Portland, Oregon, facility. The IRS number used by this account is 99-999999999. Ms. Karalina Backstrom, Supervisor of the Traffic Department, is the Point of Contact for this account.

SCOPE OF PLAN: The compliance portion of this plan covers all of the account's importations which are in the Primary Focus Industry of Communications. Previous analysis on the account's importations found some weaknesses in their cell phone entries in the areas of classification and valuation. These discrepancies are addressed in this report.

The business goals of the plan include the account's goal of setting internal controls to address the above issue. The Compliance Assessment Team, in conjunction with the Port Account Team suggested that the account develop a plan to conduct "self-tests" of its compliance, and this is incorporated into this plan. Also in the plan is the account's request that Customs assist them in ensuring that new products are correctly marked with the country of origin.

PROJECT LIST

I. COMPLIANCE ISSUES - Action: Importer

- A. Classification:** An ongoing Compliance Assessment Audit disclosed that some entries were being misclassified despite the fact that Product Code Sheets were completed correctly and included in the entry package. These code sheets from Svenska Industries describe their products in detail and are provided to the filer in order to assist in classification. There was also a potential for Loss of Revenue.

TARGET DATE: September 1, 1997

- Step 1: Ms. Karalina Backstrom, Supervisor, Traffic Department, will contact the filer of the account's entries to explain/discuss the nature of the discrepancy.
- Step 2: The filer will be asked to establish a method to ensure that their classifiers are utilizing the Code Sheets to the fullest extent.
- Step 3: Ms. Backstrom will verify and ask the Customshouse broker to ensure steps are in place and to take extra care in the preparation, examination of documentation, and filing of these entries.
- Step 4: The Traffic Department will review entry documentation to verify that the merchandise is being classified correctly.
- Step 5: Two months from now (August 1997), the account will perform a self-test to verify that entries are being properly entered at the time of entry presentation. The account will report its findings to the Port Account Team.

- B. Valuation:** Also disclosed during the Compliance Assessment Audit were discrepancies in transaction value because the foreign currency conversion rates used by the filer were incorrect.

TARGET DATE: October 1, 1997

- Step 1: Ms. Backstrom will analyze current procedures to determine the best method to correct these discrepancies.
- Step 2: Svenska Industries will contact the broker to reiterate the importance of exercising reasonable care in the submission of their entries.
- Step 3: After completion of the entry by the Customshouse broker, copies of the entry package will be forwarded to Svenska Industries for review.
- Step 4: All broker calculations will be verified for accuracy.
- Step 5: Ms. Backstrom will ensure that internal controls are in place so that if any discrepancies are discovered, the broker will be notified immediately to make the necessary corrections.

C. Internal Controls

TARGET DATE: December 1, 1997

Ms. Backstrom will work to improve the account's current internal controls as they relate to Customs Compliance. The account agrees to develop and perform internal controls which cover at least the following basic compliance areas.

- 1) Tariff Classification
- 2) Valuation
- 3) Entry Documentation
- 4) Marking

II. BUSINESS ITEMS: None

III. ITEMS REQUESTED BY ACCOUNT:

Ms. Backstrom requested assistance from the PAT in ensuring that new products imported by Svenska Industries will have the correct marking prior to importation into the U.S. Some of Svenska Industries products are imported as components and are further assembled in the U.S. with components from a variety of countries of origin. There also appears to be a problem with non-uniformity in marking enforcement, as some ports release shipments with no problem and other ports issue marking notices on the same items.

TARGET DATE: August 1, 1997

- Step 1: View products/components in question and obtain information regarding their country of origin, use, how they are sold, etc.
- Step 2: Discuss how account may obtain marking ruling letters from HQ.
- Step 3: Research any existing marking ruling letters from HQ.
- Step 4: Contact all other Ports of Entry to verify marking requirements.

Step 5: Recommend uniform procedures be put in place at all ports.

Step 6: Verify uniformity.

Step 7: Follow-up with account.

COMPLIANCE ISSUE PRIORITIES:

1. Classification (Medium)

2. Valuation (Medium)

3. Internal Controls (Low)

ACCOUNT ISSUE PRIORITIES:

1. Marking (Low)

Appendix 6. ENFORCEMENT EVALUATION TEAM PROCESS

The Process below is the overview of the Enforcement Evaluation process.

- 1. Monitor Compliance**
Compliance is monitored by all Customs officers at the transaction and account level to detect patterns and individual instances of non-compliance.
- 2. Detect Non-Compliance**
A Customs officer detects non-compliance or suspects a possible violation in a variety of areas: a discrepant transaction, CA findings, or a downward compliance trend noticed through account analysis.
- 3. Determine Impact Level**
A Customs officer determines the Impact Level of the discrepancy/possible violation: Level 1-High Impact, Level 2-Medium Impact, or Level 3-Low Impact. Level 1 and Level 2 violations are referred through an Enforcement Evaluation Coordinator (EEC) to an Enforcement Evaluation Team (EET).
- 4. Identify EET/Refer to EEC**
The appropriate EET is identified. Lead EET's are assigned to accounts with account managers and those undergoing CA's. All violations occurring within the context of a Customs account are referred to that EET. Violations by entities that are not an account are referred to the EET located where the violation was detected.
- 5. Analyze Violation/Determine Scope**
A Customs officer analyzes the discrepancy/possible violation and makes an initial determination of its seriousness and scope.
- 6. EET Determines Course of Action**
The EET jointly evaluates the discrepancy/possible violation to determine if it is an isolated instance of non-compliance or part of a larger pattern or history of violations. The EET considers input from the discovering officer, the account manager/port account team, CA team leader, as well as the significance/materiality of the violation. Based upon the nature, extent and impact of the discrepancy/possible violation, the EET selects the appropriate response to the problem.
- 7. Assign, Implement and Track Course of Action**
After a course of action is selected, the EET selects the appropriate office/port/person to implement the action. The EEC will track the course action to ensure it is effectively implemented.
- 8. Conduct Post-Enforcement Analysis**
After a defined period of time, the EEC will conduct analysis to determine if the course of action implemented removed the compliance threat and report the results to the EET. If the compliance threat still exists, a further course of action will be considered.
- 9. If Level 3, Initiate Informed Compliance**
If the Customs officer determines that the discrepancy is a Level 3 violation, he or she initiates an informed compliance action, such as outreach, a rate advance, or a Compliance Improvement Plan. Customs officers should carefully monitor repeated Level 3 violations. A continued pattern of these violations may justify a stronger Customs response and an increase to Impact Level 2.
