Customs Compliance – Has Your Business Taken the Necessary Steps?

Purolator International

Introduction

Every day more than $1.6 billion worth of goods cross the U.S./Canadian border, resulting in a 2015 trade relationship that exceeded $575 billion. The two countries have historically been each other's largest trading partners (China surpassed Canada in late 2015 as the largest source of U.S. imports), and each has expressed an interest in finding ways to increase the amount of goods crossing between the two countries. Left unsaid though is the increased scrutiny by border agents on either side of the border to ensure compliance with all U.S. and Canadian import, export, and security regulations.

Both the U.S. Customs Border Protection (CBP) agency and the Canada Border Services Agency (CBSA) have indicated an increased focus on compliance verification audits. According to Chicago, Illinois-based Livingston International customs broker, this means that all importers, regardless of size or industry, will eventually be audited. As any company that has previously undergone a customs compliance audit can attest, the process is extremely time-consuming and punishment for noncompliance can be harsh.

But for an alarming number of U.S. businesses, compliance has yet to register as a front-burner issue. Research by Aberdeen found "a disturbing 71 percent of all companies surveyed complain that internal stakeholders outside of the compliance department do not understand the impact of their actions on trade compliance or the risks associated with noncompliance."

This is especially troubling since the shipper – and not its logistics provider or customs broker – bears ultimate responsibility for any compliance mistakes. In some instances, a company's employees may be held personally liable for errors. A 2014 appeals court decision sent shockwaves through the trade community when it found in *U.S. v. Trek Leather* that Mr. Harish Shadadpuri, the company president, was personally liable for failing to accurately report information about manufacturing costs.

"...a typical audit takes more than a year to complete and roughly 1,000 hours of staff time."

Source: Livingston International

Beyond the threat of personal liability, poor compliance also puts a business at risk for an audit, which will cause significant disruption. As noted by Livingston, a typical audit takes more than a year to complete and roughly 1,000 hours of staff time. This is in addition to fines and other punitive actions that may be levied should any violations be uncovered.

Businesses can mitigate the impact of compliance-related costs by taking proactive steps to avoid mistakes and ensure that all paperwork is accurate and required documentation is provided. To do this though many businesses will need to undergo a sea change in thinking and elevate compliance management to a top priority. A report by Ernst & Young LLP, based on surveys of more than 300 senior executives from across the world, determined several common themes in minimizing the risk of noncompliance:

- Enhancing and leveraging risk management programs so that risk assessment occurs on a regular basis.
- Ensuring mechanisms are in place to capture all required data, and designating a centralized repository for storing that information.
- Making certain that every employee understands the importance of compliance and the business's requirements for capturing and storing data and records. This includes ongoing training, development of trade policies, and establishment of a "Customs Council" to ensure regular assessment and intercompany communication.

While a business can never eliminate the risk of noncompliance, steps like these can help identify potential areas of vulnerability. As many U.S. businesses have learned the hard way, "We didn't know" is not a viable excuse when confronted by CBP agents with a noncompliant shipment.

The following discussion will detail the mistakes that most often result in noncompliance and offer suggestions about how a business can ensure that its shipments raise no red flags upon arrival at the border.

Understand Your Points of Vulnerability

According to U.S. Customs and Border Protection's *Guide for Commercial Importers*, informed compliance is a "shared responsibility" between CBP and importers, wherein CBP effectively communicates its requirements, and businesses and individuals are expected to take "reasonable care" to meet those requirements.

CBP assists businesses in determining if they have met the threshold for "reasonable care" through its *Reasonable Care (A Checklist for Compliance)* publication.

However, CBP also makes clear that since every import transaction is different, it would be impossible to establish a strict definition of what exactly is meant by reasonable care. Instead, the parameters for "reasonable care" are set forth in the 1993 Customs Modernization Act – "the Mod Act" – which was enacted as part of the North American Free Trade Agreement (NAFTA). CBP assists businesses in determining if they have met the threshold for "reasonable care" through its *Reasonable Care (A Checklist for Compliance)* publication. The publication includes a series of checklists that pose basic questions regarding each transaction, including the following:

- If you have not retained an expert to assist you in complying with customs requirements, do you have access to the Customs Regulations (Title 19 of the Code of Federal Regulations), the Harmonized Tariff Schedule of the United States, and the GPO publication *Customs Bulletin and Decisions*?
- Has a reasonable and knowledgeable individual within your organization reviewed the Customs documentation prepared by you or your expert to ensure that it is full, complete, and accurate?
- If you use an expert to assist you in complying with Customs requirements, have you discussed your importations in advance with that person and have you provided that person with full, complete, and accurate information about the import transactions?

- If that documentation was prepared outside your own organization, do you have a reliable system in place to ensure that you receive copies of the information as submitted to U.S. Customs and Border Protection; that it is reviewed for accuracy; and that CBP is timely apprised of any needed corrections?

Beyond these questions that apply to all transactions, the checklist poses specific questions about classification, valuation, and country of origin, which are among the most frequent causes of noncompliance.

Value Determination

Every product arriving at the U.S. border must be assigned a value that is used for a number of purposes, including assessing duties, collecting accurate statistics, and determining applicability of additional legal requirements. However, determining the correct valuation can be complicated, since many factors may need to be addressed.

Transaction Value

In general, according to CBP, the value listed on a commercial invoice should be the price a buyer in the U.S. has paid for a product (and not the amount the goods will be sold for in the U.S.). This is called the product's transaction value and should also reflect money paid for commissions, assists, royalties, production costs, and packaging, and these items should be included on the commercial invoice.

Important to note though transaction value should not include transportation or insurance costs, or any taxes paid on the item.

Failure to include the above factors, according to CBP, "is undervaluing the goods and may result in penalties." The agency also advises that all prices in foreign currency must be converted to U.S. dollars on invoices and other entry documents.

Non-Transaction Value

In some situations, it is not possible to assign a transaction value. In those situations, CBP maintains alternate processes for determining value, which are applied in this order:

- **Transaction Value of Identical Merchandise**
- **Transaction Value of Similar Merchandise**
- **Deductive Value** – This is essentially the resale price in the United States, with deductions for certain items. According to CBP, the deductive value is generally calculated by starting with a unit price and making certain additions to, and deductions from, that price.
- **Computed Value** – If none of the above valuation methods can be applied, a computed value may be determined. This consists of the sum of the following items: Materials used in producing the merchandise + Profit and general expenses + Packing costs.

CBP Checklist Questions

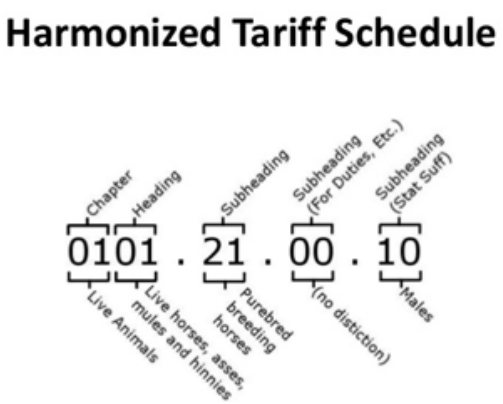
To ensure accuracy of a valuation assignment, an importer should review CBP's "checklist questions" with regard to valuation. Examples of these questions include:

- Do you know or have you established reliable procedures to know the price actually paid for your merchandise?
- Do you know the terms of sale (i.e., rebates, tie-ins, royalties, assists, commissions, etc.)?
- Are amounts actual or estimated?
- Are you and the supplier related parties? If so, have you established procedures to ensure that you have reported that fact upon entry?
- Have you provided or established reliable procedures to provide CBP with proper declared value in accordance with statutory requirements?
- Have you obtained a Customs "ruling" regarding the valuation of the merchandise?

Once a valuation is determined, that information is provided to CBP. Customs agents will review, and if a valuation seems questionable, they will either delay the shipment, pending additional information, or possibly reject the claim outright and impose a financial penalty on the importer.

Tariff Classification

Every product entering the United States must bear a 10-digit identifying code, as found in the Harmonized Tariff Schedule of the United States (HTS), which is maintained by the U.S. International Trade Commission. The HTS includes more than 17,000 different product classifications, known as "subheadings," which can vary based only on slight product variations. But, since each subheading carries a different duty rate, it is very important for the right subheading to be assigned.



Example of tariff classification based on U.S. Harmonized Tariff Schedule

For exporters, a 10-digit code must also be assigned, but that code must come from the U.S. Census Bureau's "Schedule B." Schedule B codes are rooted in the HTS, but are intended to capture different information and therefore not identical.

Interesting to note, according to analysis by international legal firm Hughes, Hubbard & Reed LLP, prior to the 1993 implementation of the Mod Act, responsibility for assigning a tariff classification code fell to Customs. "Now, however," the analysis note, "the Mod Act requires an importer to use reasonable care to itself classify the goods, i.e., to determine the proper HTS subheading for each imported product and enter that subheading number on documents filed with the entry."

But with thousands of subheadings from which to choose, how can an importer be certain to select the right code? According to CBP, there is only one "right" code for each product, but determining that precise code can be a challenge.

As CBP notes on its website: "Some products are named in the Tariff Schedule and can be found by searching for the name. Be aware though that finding a name of a product does not guarantee a correct classification. Consider the classification of a kitchen paring knife with a ceramic blade. A word search of casual browsing through the Tariff Schedule might lead to heading 8211 ('Knives with cutting blades, serrated or not….'). However, Chapter 82, Note 1 excludes articles with a blade of ceramic from Chapter 82. The proper classification is in Chapter 69 as an article of ceramics."

Clearly then, determining the proper classification can be confusing, and mistakes can be made easily. Great care must be exercised, and an importer must avail itself of a number of tools available to facilitate the process:

- **HTS General Notes.** The Harmonized Tariff System includes detailed guidance in the form of "General Rules of Interpretation," "Additional U.S. Rules of Interpretation," and legal notes that accompany each HTS chapter. These resources should be consulted whenever questions arise about proper classification.
- **Online "tariff lookup tools" are available for both U.S. importers and exporters.** The International Trade Commission offers an online database for importers, and the U.S. Census Bureau maintains a Schedule B lookup tool through which Schedule B export codes can be identified.
- **CBP maintains a database of all prior tariff classification challenges.** That database, the Customs Rulings Online Search System (CROSS), provides an updated list of all prior customs rulings which, can serve as precedents when establishing rationale for use of a lower-tariff category.

CPB Checklist Questions

To further assist shippers, CBP offers a range of questions intended to ensure that proper steps have been followed in making a tariff classification. Those questions, found in CBP's *Reasonable Care (A Checklist for Compliance)* publication include the following:

- Where merchandise description or tariff classification information is not available, have you established a reliable procedure for obtaining it and providing it to CBP?

- Have you participated in a CBP classification of your merchandise in order to get it properly described and classified?
- Have you consulted the tariff schedules, CBP informed compliance publications, court cases, or CBP rulings to help you properly describe and classify the merchandise?

According to CBP, there is only one correct classification code for each product. But the right classification can sometimes be open to interpretation. CBP has the authority to "make classification decisions and may disagree with reasonable classification offered by the importer."

Origin Determination

Importers also have an obligation to provide CBP with specific information about a product's country of origin. This information is necessary for several reasons, including the following:

- Determining eligibility for free trade agreement benefits
- Determining rate of duty
- Assessing applicability of antidumping or countervailing duties
- Determining eligibility for import into the United States

In many instances in which a product is 100 percent grown or produced in a single country and proof of that origin is easily proven, compliance with CBP requirements is not difficult. Unfortunately, this is not usually the case.

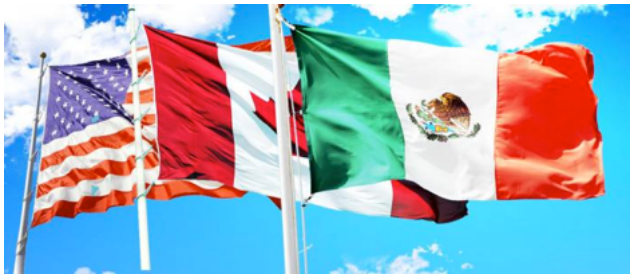
As a Hughes, Hubbard & Reed legal analysis notes, since many imported goods consist of materials from more than one country, or are manufactured in processes performed in multiple countries, complex rules have been established to determine the country of origin. In these instances, a "substantial transformation" standard is most often applied, whereby country of origin is determined by the country in which the product last underwent a process resulting in the article having a new name, character, or use distinct from that of the article or articles from which it was transformed.

According to the Hughes, Hubbard & Reed analysis, this criterion is applied on a case-by-case basis and has been the subject of many court decisions and customs rulings. Nevertheless, importers are expected to exercise "reasonable care" in determining country of origin, and customs has included related questions in its Reasonable Care publication. Among the questions related to country of origin:

- Have you consulted with a customs expert regarding the correct country-of-origin/proper marking of your merchandise?
- Have you assured that the merchandise is properly marked upon entry with the correct country of origin?
- Have you apprised your foreign supplier of CBP country-of-origin marking requirements prior to importation of your merchandise?

Importers are required to exercise "reasonable care" in determining a product's country of origin.

NAFTA Certificate of Origin



Source: U.S. Trade Representative

In addition, U.S. importers who apply for benefits under the terms of the North American Free Trade Agreement (NAFTA) must be in compliance with the agreement's very specific rules for determining country of origin. Most shippers understand that NAFTA essentially eliminates duties on all "domestically produced" goods moving among the United States, Canada, and Mexico, but determining what constitutes domestic production can be very confusing.

NAFTA includes special rules that determine what percentage of non-NAFTA components can comprise a finished product and still qualify for preferential treatment. These rules are known as the "NAFTA Rules of Origin." For every product, there is a rule of origin, but deciphering the complex language of each rule can be difficult.

When eligibility for NAFTA benefits is in doubt, a shipper may seek an advance ruling, whereby CBP will validate – or change – the assigned country of origin and determine eligibility for NAFTA benefits. NAFTA advance rulings are binding and eliminate any uncertainty with regard to duty-free eligibility.

Once eligibility is determined, a NAFTA Certificate of Origin must be completed and filed with all other shipment documentation. However, completing the certificate of origin can be a highly confusing, exacting process. A business must entrust this responsibility to a highly trained employee, or to a qualified customs broker or logistics provider. Improper claims for NAFTA eligibility may result in significant penalties assessed on the individual who signed the form or made the claim.

In fact, incorrect origin determination is a leading reason for shipments being held at the border or being subject to Customs fines and penalties. Further, if CBP determines that a shipper has either failed to provide a certificate of origin on at least two occasions, or has repeatedly reported incorrect information, that shipper may have future preferential tariff treatment suspended.

Record-keeping

U.S. exporters and importers are required by law to retain copies of all trade-related documentation for a set period of time.

The Customs Modernization Act (Mod Act), which was enacted in 1993 as part of NAFTA, updated previous record-keeping requirements for importers, brokers, and other members of the trade community. In general, businesses must maintain all records that are used to prepare Customs entry forms. A complete list of required documents (known as the [a][1][a] list) can be found in U.S. Treasury Directive 96-1. In addition, companies must keep all other business, financial, and accounting records "ordinarily maintained for normal business transactions." All records related to U.S. transactions must be maintained for a minimum of five years.

Any business that fails to comply with terms of the Mod Act will face significant penalties:

- **Willful failure to maintain or produce (a)(1)(a) list records:** Penalties not to exceed $100,000 per release or 75% of the appraised value, whichever is lower.
- **Negligent failure:** Penalties not to exceed $10,000 per release or 40 percent of the appraised value, whichever is lower.

U.S. businesses must also comply with strict record-keeping requirements mandated by the ***Sarbanes-Oxley Act.*** This legislation, enacted in 2002, imposes strict record-keeping and retention mandates for a broad spectrum of documents – including electronic documents and records – on public companies, and it carries severe penalties for noncompliance. For example, legal analysis by Pannone Lopes Devereaux & West notes that any attempt to "alter, cover up, falsify, or destroy" any affected document could result in extensive fines and/or imprisonment for up to 20 years.

Further, Livingston International notes that U.S. Customs authorities have increased expectations for compliance capabilities. "U.S. Customs authorities have moved away from allowing importers time to produce or find a requested Certificate of Origin," the customs broker noted in a white paper. "More frequently, failure to produce the documents upon request is leading to an immediate penalty of $10,000 for noncompliance, and up to $100,000 per infraction for fraud."

Poor record-keeping has long been among the biggest reasons for non-compliance. In fact, as legal analysis from Katten Muchin Rosenmann LLP notes, businesses' failure to prioritize record-keeping became so problematic, that CBP's recent increased emphasis on fines and penalties was largely conceived as a way to spur businesses to take seriously the need for internal record-keeping practices.

"More frequently, failure to produce the documents upon request is leading to an immediate penalty of $10,000 for noncompliance, and up to $100,000 per infraction for fraud."

Source: Living International

Duty Drawback

Duty drawback is a voluntary process, whereby shippers can apply to CBP to receive a reimbursement of up to 99 percent of import duties that are paid on materials that enter the U.S. and are either used in the manufacture of products that are subsequently exported or are destroyed. A successful drawback claim can be quite lucrative to an importer, since a business has up to three years from date of the original import to submit a claim.

However, as CBP forewarns potential filers: "Be aware the process of filing for drawback can be involved and the time it takes to receive refunds can be lengthy." Integral to any successful drawback claim is proper record-keeping and compliance with documentation requirements. Any entity, including an importer or a broker acting on its behalf, must be certified and demonstrate a firm understanding of the drawback process. The duty drawback process is discussed in detail in CBP's publication, *What Every Member of the Trade Community Should Know About: Drawback.*

Most businesses delegate the drawback filing process to a qualified logistics partner or customs broker. But keep in mind that the importer bears ultimate responsibility for all documentation submitted to CBP, so steps should be in place to ensure complete, accurate, and accessible records are maintained.

As CBP forewarns potential filers: "Be aware the process of filing for drawback can be involved and the time it takes to receive refunds can be lengthy."

Source: CBP Website

Proactive Compliance

Since the risk of noncompliance exists for any business, as does the chance of being selected for a customs audit, smart businesses will take steps to proactively avoid problems and to plan for an audit as a way to minimize disruption and the likelihood of incurring monetary penalties. Among the steps an importer must consider:

Internal Controls. According to the Hughes, Hubbard & Reed legal analysis, the most effective way to minimize the risk of customs problems is to establish an internal corporate compliance program. That is an opinion echoed by many in the trade community, including CBP. The U.S. Customs agency has published a list of "best practices" for a company to adopt in developing a compliance process. Those best practices include the following:

- **Commitment from management**
  - Statement from Board of Directors assigning authority and responsibility to an internal customs group
  - Firm statement from senior management to employees that addresses importance of compliance and outlines internal processes
- **State compliance and cost goals**
  - Identify and analyze risks and areas of vulnerability, and develop internal goals to address potential weaknesses
- **Develop formal policies**
  - Develop, implement, and/or modify formal policies and procedures to ensure that management's goals and objectives are met
  - Policies should be written and included in a comprehensive compliance handbook that is updated regularly and disseminated to all employees
- **Establish training programs**
  - Ensure employees receive appropriate training and guidance to effectively discharge their responsibilities
- **Conduct internal control reviews**
  - Conduct periodic process reviews to assess the performance quality of internal controls
- **Create compliance group**
  - Establish a customs group
- **Establish a record-keeping program**
  - Maintain a record-keeping system that forms an audit trail from production control through payment to CBP entry
  - Provide supporting documentation for CBP transactions in a timely manner
- **Develop compliance requirements for suppliers**
  - Develop and implement controls to help ensure that CBP requirements are satisfied and documented
- **Partner with CBP**
  - Participate in voluntary CBP programs, including Customs-Trade Partnership Against Terrorism (C-TPAT), Container Security Initiative (CSI), Importer Self-Assessment (ISA), Free and Secure Trade (FAST), and Automated Commercial Environment (ACE)

An importer can apply to customs for an advance customs ruling for a binding decision with regard to product classification or valuation.

Advance Customs Ruling. An importer can avoid having a tariff classification or valuation challenged at the border by requesting a binding advance ruling prior to filing shipment documentation. In fact, CBP "strongly urges" all affected parties to seek "binding advice" from CBP as a way to eliminate uncertainty and facilitate the clearance process. All advance ruling requests must be submitted in writing and include detailed information about the product in question, including content information, transaction history, and photographs/drawings. In addition, the ruling process allows an importer an opportunity to "make its case" about why its product should be treated in a certain way. For example, an importer may prefer its shipment's country of origin be listed as the United States so its products can be labeled "Made in the U.S.A." Once the ruling is issued, CBP is bound by the decision, regardless of the shipment's point of entry.

Voluntary Disclosure. Should an importer realize it has failed to exercise reasonable care in reporting information to CBP, and that failure has resulted in errors on entry documentation, the company can voluntarily disclose the information. By voluntarily reporting the error, an importer can significantly reduce the amount of penalties that would have been imposed had CBP discovered the mistake and initiated an investigation. According to CBP, an importer must provide a written report explaining the circumstances of the violation that includes the nature of the error or incorrect information submitted, the identity of the entries or period to which the disclosure applies, and the correct information that should have been included in the original documentation.

Post Entry Amendment (PEA). Should an importer need to correct or amend information supplied to CBP after documentation has been filed, it can do so via a Post Entry Amendment. According to analysis by Wiley Rein LLP, PEAs may be filed at any time after goods are entered into the country, up to 20 days prior to the scheduled date of liquidation (usually 314 days after entry). PEAs can be used for a variety of purposes, including to correct errors that resulted in overpayments or underpayments of duties, or to correct inadvertent misclassifications.

Self-Assessments. An importer can detect any potential compliance issues by putting itself through a proactive assessment drill, either acting on its own or as a member of CBP's Importer Self-Assessment program.

The Importer Self-Assessment (ISA) program was launched in 2002 and is available to businesses that are certified members of CBP's Customs-Trade Partnership Against Terrorism program. Through ISA, CBP works directly with importers to evaluate and build systems of internal controls while strengthening the lines of communication and encouraging importers to view CBP as a strategic ally in ensuring compliance. ISA participants receive certain advantages, including minimized risk of being selected for a Focused Assessment audit, in exchange for allowing CBP to focus its resources on high-risk shipments.

Self-Administered Assessments. Non-ISA certified importers can also benefit from putting themselves through a self-assessment. According to Hughes, Hubbard & Reed legal analysis, a business can conduct the equivalent of an official CBP Focused Assessment as a way to identify problems that need to be addressed and internal systems that need to be created or strengthened. Through the self-assessment, a thorough examination takes place of a company's overall importing and import entry processes. Foreign vendor payments are reconciled with Customs entry statistics, and transactions are tested in trade areas in which controls may be weak. This type of exercise can be helpful for companies that have never been audited as a way to develop a comprehensive compliance program.

The CBP Review/Audit Process

U.S. Customs and Border Protection

The first sign that something may be amiss with a Customs filing is the receipt of a "CF-28" form. This form is a request from CBP for additional information and, according to Turtle Law, is issued when CBP believes it has insufficient information to determine admissibility, the appraised value, or to make a correct classification determination. An importer has 30 days to respond to a CF-28 inquiry, and should use that time to determine what triggered the inquiry, consult with a customs broker or some other party with expertise, and prepare a detailed response.

An importer may also be in receipt of CBP CF-29, which is a "notice of action" and an indication either that issues outlined in the CF-28 were not sufficiently addressed or that Customs is moving ahead based on information included in the original entry documentation.

This form will indicate that CBP is either "proposing" a certain course of action or that action has already been taken. If a certain remedy is proposed, an importer has 20 days in which to respond. But if action has already been taken, the only recourse is to file a formal protest. CBP generally uses CF-29 to alert an importer of actions that include the following:

- Assessment of additional duties
- Initiation of liquidation process
- Assessment of antidumping duties based on country of origin

Forms 28 and 29 must be taken seriously and all requested action addressed within the specified time frame. Failure to do so can result in civil fines, additional penalties, and forfeiture proceedings.

Focused Assessments and Quick Response Audits

An importer may also receive notification that is has been selected for an audit. Generally that notification comes via a telephone call and is followed up with a letter. In recent years, CBP's auditing practices have undergone a shift. Whereas the focus used to be on "catching" importers and assessing penalties, today it is much more risk-based and proactively seeks to help importers implement an "informed compliance" strategy.

CBP offers two main types of audits: Focused Assessments (FAs) and Quick Response Audits (QRAs).

Most common errors found during Customs audits:

- Failure to report assists
- Failure to report supplemental payments
- Failure to justify deduction of non-dutiable costs (i.e., CIF costs)
- Errors in clawssification
- Lack of documentation to support claims
- Lack of support for listed transaction values
- Failure to disclose third-party commissions
- Record-keeping errors

Source: George Tuttle Law Offices

Focused Assessment (FA)

A Focused Assessment is a CBP-administered comprehensive audit of an importer's compliance processes. The audit is conducted by CBP's Regulatory Audit division (RA). Importers are selected on a risk-based approach. According to analysis by Braumiller International Trade Law Group, Focused Assessment selection is based on an importer's "volume and the value of their entries, and any risk areas identified through a review of the company's import data." A Focused Assessment takes place in three clearly delineated stages:

Pre-Assessment Survey (PAS). Every importer selected for a Focused Assessment must complete an Internal Control Questionnaire as a way to obtain information about the company's organizational structure and internal controls related to Customs transactions. Once the questionnaire is complete, CBP's Pre-Assessment Survey team will analyze the responses to plan an overall approach to the Focused Assessment.

The results of the questionnaire, interviews with company officials, examination of company procedures, and limited testing will be used to determine the effectiveness of the company's internal control program.

Assessment Compliance Testing (ACT). During this phase of the audit, Customs will address inefficiencies and vulnerabilities identified during the PAS. According to CBP, criteria for unacceptable risks includes the following:

- The company does not maintain adequate internal controls, and ACT testing is necessary to determine the level of compliance of the company's imports.
- The FA team is not able to confirm that internal controls are adequate to control risks to Customs, and ACT testing is necessary to determine the level of compliance of the company's imports.
- Revenue issues are involved but cannot be resolved without additional testing by the FA team.
- According to Braumiller, upon finalizing the test results, if significant risk is found, the loss of revenue is calculated and a Compliance Improvement Plan (CIP) is established for each risk area identified. If no significant risk is found, an audit opinion is issued, usually with no loss of revenue identified or penalties assessed.

Follow-Up. The follow-up phase is used to determine whether corrective actions specified in the Compliance Improvement Plan were implemented and to gauge effectiveness in correcting the deficiencies identified during the Focused Assessment. As noted by Livingston International, a Focused Assessment will typically take a year to complete and require more than a thousand hours.

Quick Response Audit (QRA)

The Quick Response Audit is used when noncompliance is suspected in a single, specific area. For example, CBP might initiate a QRA to determine if there is a potential for transshipment or an audit of a company's controls concerning intellectual property rights.

QRAs generally originate from referrals by CBP and Homeland Security offices, whereby a particular importer is identified as a potential risk for certain types of transactions. An importer may also be a likely candidate for a QRA if there is a past history of failed audits, violations, prior disclosures, or inquiries from account managers. Unlike the lengthy and comprehensive Focused Assessment, the QRA poses significantly less of a burden.

According to information presented by George Tuttle Law Offices, most common errors found during Customs audits include:

- Failure to report assists
- Failure to report supplemental payments
- Failure to justify deduction of non-dutiable costs (i.e., CIF costs)
- Errors in classification
- Lack of documentation to support claims
- Lack of support for listed transaction values
- Failure to disclose third-party commissions
- Record-keeping errors

The Costs of Noncompliance

Any communication from CBP should be treated as a front-burner issue. While there is generally no need to panic, an importer should take immediate action to comply with the terms of the notification. If an importer has a solid compliance process in place, it should dictate the precise steps to follow. Those steps should include the following:

- Notify executive management
- Designate one individual as the CBP point person
- Determine if there is a need for prior disclosure
- Answer all questions completely and accurately
- Provide all documentation within time frames provided
- Be prepared to devote significant time and resources
- Review and understand all responses before presenting information to CBP auditors

CBP has an arsenal of options when it comes to assessing penalties for customs noncompliance. Common penalties include monetary fines and penalties, shipment seizure (with importer required to pay costs for storing shipment), and an increased likelihood of future audits. In addition, an importer must also take into account the impact a CBP penalty or delay will have on its shipment delivery, especially if a shipment has a date-certain scheduled delivery time, as required to meet a just-in-time production schedule.

Integral to what, if any, penalty is assessed is the scope of the violation, an importer's prior history, and whether or not the error is deemed to have been caused by negligence or willful error.

During Fiscal Year 2015, CBP levied monetary penalties totaling over $60 million on importers for fraud, gross negligence, and for antidumping/countervailing duties violations. The agency seized shipments with a total value of more than $5 million and, through audits, identified $69 million in anti-dumping/countervailing duty discrepancies.

Conclusion

A few years ago the Ford Motor Company was fined more than $20 million for a series of import violations that included under-claiming the value of imports and failing to report assists on entry documentation. In issuing the fine, the company was deemed to have been “grossly negligent” and “reckless,” and to have exercised an “utter lack of care” about its obligations.

While the Ford Motor Company undoubtedly takes seriously the need for Customs compliance, and has extensive compliance protocols in place, this example indicates the relative ease with which a company can find itself in noncompliance. The example is also indicative of the seriousness with which Customs – and the courts – approach noncompliance matters.

Although most importers are certainly not on the same scale as Ford, each business must take seriously the need to have in place proper internal compliance controls. A good first step is to consult with an experienced customs broker or logistics provider to map out a comprehensive compliance process. While notification of a Customs audit will never be welcome news, it doesn’t have to strike fear and terror throughout an organization.

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