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Report to Congressional Requesters

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CUSTOMS AUTOMATION

Internal Control Weaknesses in Customs' Revenue Collection Process

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Information Management and
Technology Division

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The Honorable Dennis DeConcini
Chairman, Subcommittee on Treasury, Postal
Service, and General Government
Committee on Appropriations
United States Senate

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

In a February 10, 1989, letter, the Chairman of the Subcommittee on Oversight, House Committee on Ways and Means asked GAO to determine whether the internal controls in the Customs Service's Automated Commercial System (ACS) are adequate to ensure that all Customs revenues collected are deposited in the U.S. Treasury. Since similar information was also being gathered under a request from the Chairman of the Subcommittee on Treasury, Postal Service, and General Government, Senate Committee on Appropriations, we agreed with both Subcommittee offices to provide this interim report summarizing selected information we had obtained to date. We will be reporting later on Customs' revenue collection process and the role that the Automated Commercial System plays in this process.

ACS is being developed to automate and place in one integrated system all of Customs' commercial operations for inspecting merchandise imported into this country and collecting duties, taxes, tariffs, fines, and penalties. In fiscal year 1988, imported merchandise was valued at over $430 billion, and Customs collected nearly $17.5 billion in revenues. The Financial System module, a critical part of ACS, is already operational. This system is designed to collect, account for, and control these revenues.

Based on our preliminary work, we noted two major frauds that resulted in the theft of over $4.2 million in revenues and further noted Customs' inability to reconcile collection and deposit amounts recorded in ACS. As of February 1989, Customs reported that collections exceeded deposits by the cumulative unreconciled amount of about $53.5 million. Customs and the Department of the Treasury have been aware of internal control weaknesses since at least 1987. In 1987, we reported weaknesses in ACS' internal controls.[1] In 1987 and 1988, Treasury reported material control weaknesses in Customs' accounting systems and revenue collection process. In December 1988, Customs stated in a management assessment report that the process of collection, deposit, and reconciliation is and has been in "total disarray" since at least 1985. As a result of these problems, Customs is questioning the design of the Financial System module and the manual controls for collecting and accounting for revenues.

During the last two and one-half years, there have been major frauds at two ports, resulting in repeated thefts totaling over $4.2 million in revenues. One fraud, at the Port of Chicago, extended over a 2-month period and involved the theft of over $3.4 million in deposits that were picked up by a courier for delivery and deposit in a bank. Customs' deposit reports showed that the thefts involved a series of 10 deposits that were reported as being sent to the bank, although the bank had not reported the deposits as received. Customs officials stated that these thefts were not detected until the courier company became suspicious of its own employees and informed port officials.

The other theft occurred at Los Angeles International Airport, where a former Customs supervisor is alleged to have stolen approximately $839,000 in collections during a 1-year period. This employee allegedly did not deposit funds received, and falsified documents to cover up the thefts. The process of collecting revenues requires the cashiers to use controlled, serially numbered documents when providing a receipt to the payee. These numbers are entered into ACS with the amount collected so that any missing documents can be identified later. However, Customs port officials stated that the thefts were discovered when they received an inquiry from a former payee asking why Customs had not cashed a check that was paid for duties owed.

Customs has been unable, in any given month, to balance the amount of funds recorded in ACS as deposited in banks with the amount of funds recorded as collected. As of February 28, 1989, recorded collections exceeded deposits by about $53.5 million. Customs' cumulative unreconciled balance has ranged from about $26.8 million to about $60.8 million each month, since the beginning of fiscal year 1988. Customs' records show that the cumulative unreconciled balance has always resulted in

[1] System Integrity: Stronger Controls Needed for Customs' Automated Commercial System (GAO/IMTEC-87-10, Feb. 10, 1987).

recorded collections being greater than recorded deposits. Customs officials stated that their inability to reconcile recorded collections to deposits is not new and actually predates the establishment of the Financial System module in 1984.

We noted that this problem of reconciling continues to occur even though ACS procedures require recorded collections to equal recorded deposits each day. In the opinion of these officials, this unreconciled balance occurs because an automated reconciliation between collections and deposits at the end of each month cannot be performed because of ACS software limitations. For this report, we did not attempt to determine the exact nature of these limitations and their impact on the reconciliation process. Given the limitations of the system, it is impossible for us or Customs to determine at this time whether any money is, in fact, missing.

Customs officials and the Department of the Treasury have been aware of the internal control weaknesses in Customs' revenue collection process and weaknesses in the ACS Financial System module since at least 1987. Several reports have addressed internal control problems within Customs. In February 1987, we reported weaknesses in ACS internal controls identified during 1985 and 1986. In commenting on the report, the Commissioner of Customs agreed that ACS had weaknesses and he stated that he planned to take corrective action. However, he cited ACS as a resounding success and questioned the significance of the internal control weaknesses because we did not identify any actual cases of fraud, waste, or abuse involving ACS. After the report was issued, the Deputy Assistant Secretary for Information Systems, Department of the Treasury, reported to us that corrective actions were already being taken on the issues cited in our report. However, we have not yet verified the effectiveness of these actions.

In 1987 and in 1988, the Department of the Treasury reported to the President and the Congress that material internal control weaknesses existed in Customs' accounting systems and revenue collection process.[2] A Customs Internal Affairs draft report, which we obtained in January 1989, stated that Customs management does not have enough assurance

[2]The Federal Managers' Financial Integrity Act places the primary responsibility for maintaining adequate internal controls and accounting systems on federal agency managers. The act requires agency heads to report annually to the President and the Congress whether their systems comply with the Comptroller General's standards and holds managers responsible for correcting identified deficiencies.

that all funds received by Customs are properly accounted for and deposited into the U.S. Treasury.[3]

As a result of these and other prior studies, Customs management initiated an assessment of the situation and concluded in a December 1988 report that the process of collection, deposit, and reconciliation has had significant internal control problems since at least 1985. The report also pointed out that the commitment of resources to solve the problem had not received the priority commensurate with the magnitude of the systems' deficiencies. The assessment concluded that without the necessary management attention and adequate resources, the financial accounting systems will not meet required federal standards and will continue to result in material weaknesses that must be reported under the Federal Managers' Financial Integrity Act.

Senior Customs officials stated that corrections to these weaknesses have been long overdue and that action is now being taken to correct the deficiencies. In March 1989, Customs formed a task force to study the collection and deposit reconciliation problems, develop solutions, and identify the resources needed to implement these solutions. Appendix I provides detailed information regarding these issues and Customs' actions for addressing them.

To obtain the information in this report, we interviewed Customs headquarters officials and field office officials at the National Finance Center and selected ports. We also interviewed Department of the Treasury Financial Management Service staff. We reviewed Treasury's Federal Managers' Financial Integrity Act reports and selected Treasury and Customs financial statements. Our work was performed in accordance with generally accepted government auditing standards, from October 1988 to March 1989. Because of the preliminary nature of our work, we are not formulating any conclusions on the adequacy of Customs' management, activities, or systems described in this report. Further information on our objective, scope, and methodology is contained in appendix II.

We discussed the contents of this report with Customs officials and have included their comments where appropriate. As agreed with your offices, unless you publicly announce this report's contents earlier, we plan no further distribution until April 17, 1989. At that time, we will

[3] National Audit of Collections (U.S. Customs Service Office of Internal Affairs, Office of Internal Audit-88-NA-4, Draft).

send copies to the Secretary of the Treasury, the Commissioner of Customs, and other interested parties. This report was prepared under the direction of James R. Watts, Associate Director. Other major contributors are listed in appendix III.

Sincerely yours,

Ralph V. Carlone

Ralph V. Carlone
Assistant Comptroller General

Contents

Abbreviations

ACS	Automated Commercial System
GAO	General Accounting Office
IMTEC	Information Management and Technology Division

Information on Customs' Revenue Collection Process

Background

One of the Customs Service's primary missions is to assess and collect revenues in the form of duties, taxes, tariffs, and fees on imported merchandise. In fiscal year 1988, imported merchandise was valued at over $430 billion, and Customs collected about $17.5 billion in revenues. To assist in its efforts to collect, account for, and control these revenues, Customs developed the ACS Financial System module. This module is designed to work with other ACS modules, and it receives and provides data to other automated systems. These financial data are used by the Department of the Treasury, Immigration and Naturalization Service, Department of Agriculture, and Internal Revenue Service.

Overview of Customs' Revenue Collection Reporting Process

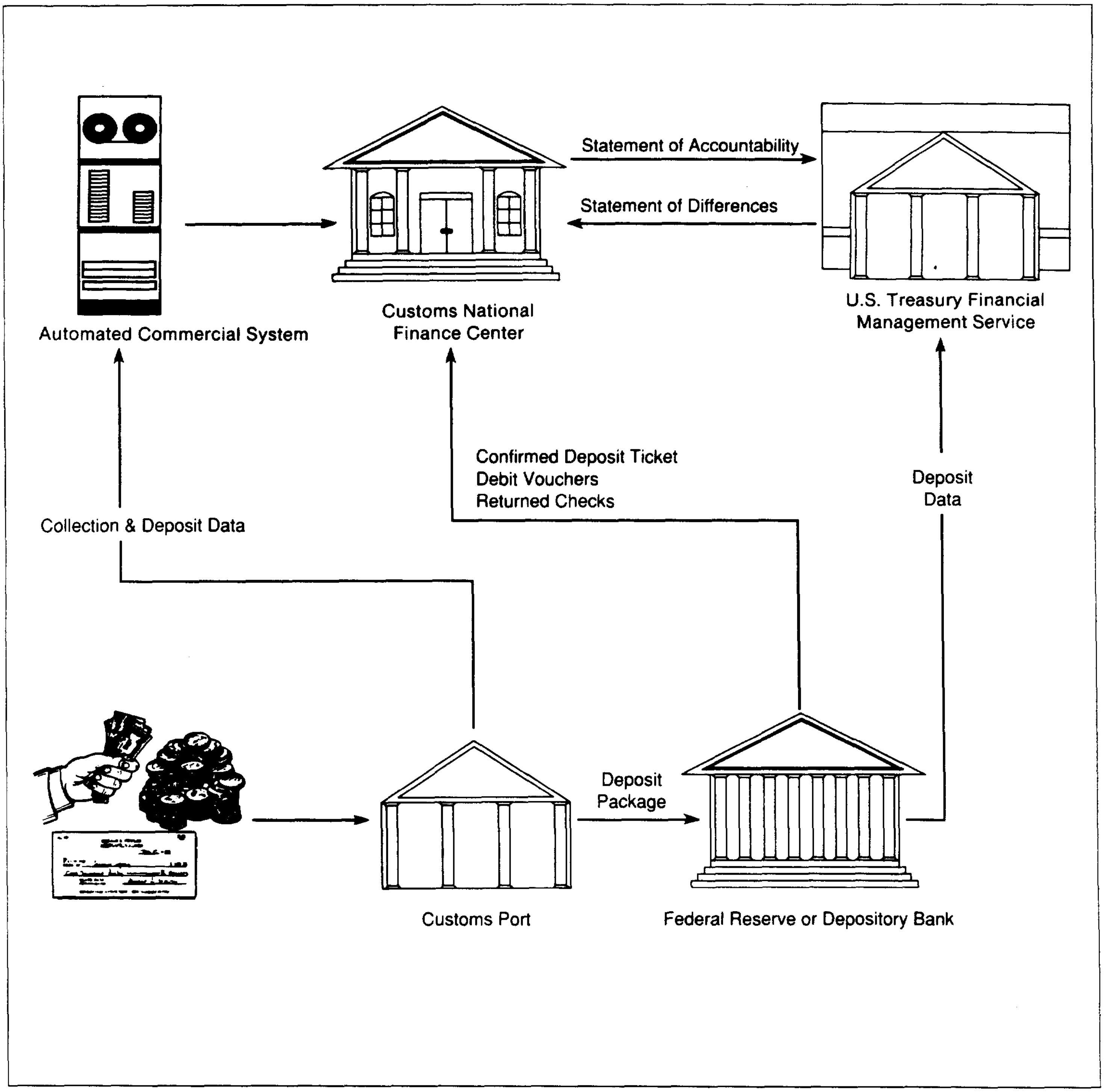
When merchandise is imported into the United States, Customs has a process that is intended to ensure that revenues due the Treasury are properly collected and accounted for. This process is discussed below and illustrated in figure I.1.

A broker or importer must file documentation with Customs when imported merchandise valued at over $1,000 arrives at a U.S. port. This documentation describes the merchandise and quantities imported along with the duties, tariffs, and taxes estimated by the broker or importer. Payment of the estimated amounts must be made within 10 days from the date the merchandise is released by Customs.[4]

When Customs receives these payments, a cashier enters the daily collections and deposit data into ACS. Deposit packages are prepared with separate deposit tickets, one for cash and another for checks collected. These packages are then transported to a financial depository (for example, a commercial bank) or a Federal Reserve Bank.

[4]A person entering the United States must also file certain documents at the port of entry declaring any imported merchandise being brought into the United States. Any duties, tariffs, or taxes assessed by the port officials must be paid immediately, before the merchandise can enter the United States.

Figure I.1: Overview of Customs' Revenue Collection Reporting Process



When a bank receives these deposits, tellers sign and date the deposit tickets, confirming that a deposit was received. Later, normally within 24 hours, the bank verifies the deposit amounts and prepares debit vouchers for adjustments such as shortages, bad checks, or counterfeit bills. The bank then forwards any bad checks from prior deposits, debit vouchers, and deposit tickets, adjusted for overages if necessary, to Customs' National Finance Center.

The National Finance Center reports monthly collection and deposit amounts obtained from the ACS system to Treasury's Financial Management Service, on a report called a Statement of Accountability. Treasury uses this information to credit collections to proper accounts and to adjust current and prior months' deposits for Customs. If this information agrees with the deposits reported to Treasury's Financial Management Service by the banks, Customs' account with Treasury is considered reconciled. If there is a discrepancy between the two accounting records, Treasury's Financial Management Service prepares a report called a Statement of Differences and forwards it to the Customs National Finance Center for resolution of the differences. This report is sent to Customs about 30 days after the receipt of the Statement of Accountability. It provides information on deposits that were actually made and reported to Treasury anywhere from 45 to 75 days prior to the date of the Statement of Differences report.

Deposit reconciliations are performed by the National Finance Center to determine the cause of the differences. Deposits unreconciled by the National Finance Center at the end of 6 months are no longer reported on the Statement of Differences. Instead, they are moved to Customs' Budget Clearing Account within Treasury by the Financial Management Service until resolution of differences by Customs.

Control Weaknesses in the Process of Revenue Collection

Although the revenue collection process is intended to ensure that all Customs revenues are deposited into the U.S. Treasury, our preliminary review identified some key facts that have Customs questioning the design of the Financial System module and its effectiveness to collect, account for, and control its revenue collection process. These facts include the theft of over $4.2 million in revenues and Customs' inability to reconcile a cumulative amount of about $53.5 million in recorded collections with recorded deposits as of February 1989. Customs' records show that the cumulative unreconciled balance has always resulted in recorded collections being greater than recorded deposits. Background surrounding these facts is discussed below.

During the past two and one-half years, two frauds resulted in the theft of over $4.2 million in revenues. These frauds occurred at two ports, one involving 10 thefts and the other 21 thefts. Customs officials stated that these thefts should have been detected and stopped after the first instance, and might have been if proper internal controls had been in place and been used.

One of these frauds involves the theft of over $3.4 million in deposits that were picked up at the Port of Chicago by a courier for delivery and deposit in a bank. ACS deposit reports for this port showed that the thefts involved a series of 10 deposits from May 26, 1988, to August 2, 1988, which were reported as being collected, but which were not received by the bank. Except for one deposit of $3,389,581 and another of $130, the thefts averaged about $3,000. Port officials stated that during this period two deposit tickets were prepared each day, one for cash deposits and the other for check deposits. Table I.1 identifies the days when funds were given to the courier but not deposited.

Table I.1: Collections Not Deposited for the Period May 26, 1988 Through August 2, 1988

Date of Deposit	Amounts Not Deposited
May 26	$3,322
June 16	2,380
June 20	130
June 21	4,045
June 21	3,389,581
July 11	1,714
July 15	1,854
July 22	2,439
July 26	4,338
August 2	4,493
Total	**$3,414,296**

Customs officials stated that these thefts were detected months later when the courier company became suspicious of its own employees and informed port officials. An investigation into these thefts is underway. Customs officials stated that these thefts occurred and were not identified by Customs for these reasons:

- Procedures do not require individual ports to receive copies of the confirmed deposit tickets from the banks. Confirmed deposit tickets are forwarded to Customs' National Finance Center.

- Customs relies on the Treasury's Statement of Differences report as the internal control; however, relying on this report allows as much as 2 months to elapse before Customs is notified that a deposit was not received or a discrepancy was noted in the amount deposited.

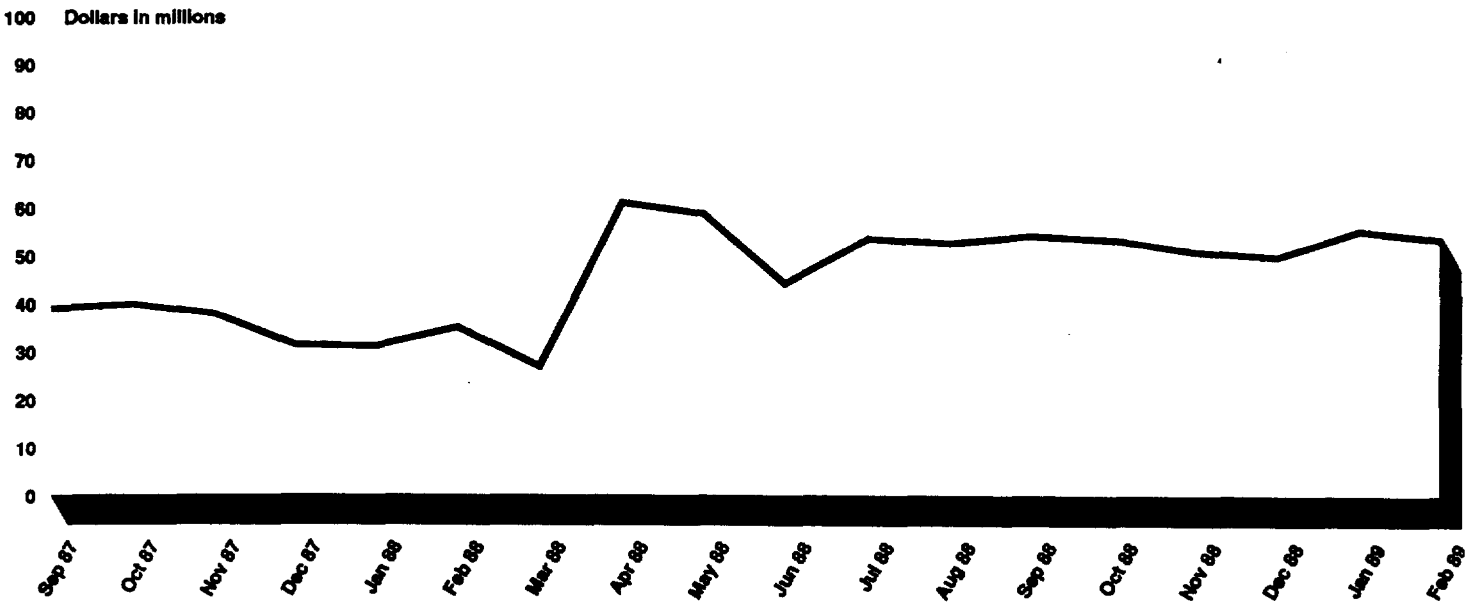
The acting director of the National Finance Center stated that Customs has drafted new procedures that would require ports to receive copies of the confirmed deposit ticket from their depository banks. Customs officials also stated that the thefts would have been discovered eventually when the National Finance Center reconciled the differences shown on the Treasury's Statement of Differences report.

Another event that indicates a control weakness occurred at Los Angeles International Airport, where a former Customs supervisor faces a 21-count indictment on embezzlement charges. The supervisor is alleged to have stolen approximately $839,000 in collections during a 1-year period. This employee, who was responsible for preparing deposit documents and forwarding collection data for input into ACS, allegedly did not deposit funds received, and falsified documents to cover up the thefts. The process of collecting revenues requires the cashiers to use controlled, serially numbered documents when providing a receipt to the payee. These numbers are entered into ACS with the amount collected so that any missing documents can later be identified. However, Customs port officials stated that the thefts were not discovered until they received an inquiry from a former payee asking why Customs had not cashed a check that was paid for duties owed.

Another indicator of control weaknesses is Customs' inability to reconcile recorded collections with recorded deposits in ACS. As of February 1989, the cumulative unreconciled amount between collections and deposits recorded in ACS was about $53.5 million. Senior Customs officials at the National Finance Center cannot explain the reason for the $53.5 million difference in their automated accounting records and stated that this difference is not supported by documentation. Rather, it is a "derived" amount used in order to balance their Statement of Accountability.

As stated earlier, ports, districts, and National Finance Center personnel enter data, on a daily basis, into ACS to record collections received and deposits sent to a bank. On a monthly basis, ACS summarizes these daily events and the National Finance Center reports these totals to Treasury on a Statement of Accountability. A review of these monthly reports prepared by Customs shows total collections and total deposits consistently out of balance. This out-of-balance or cumulatively unreconciled amount at the end of each month has ranged from about $26.8 million to about $60.8 million for the period September 1987 through February 1989. (See fig. I.2).

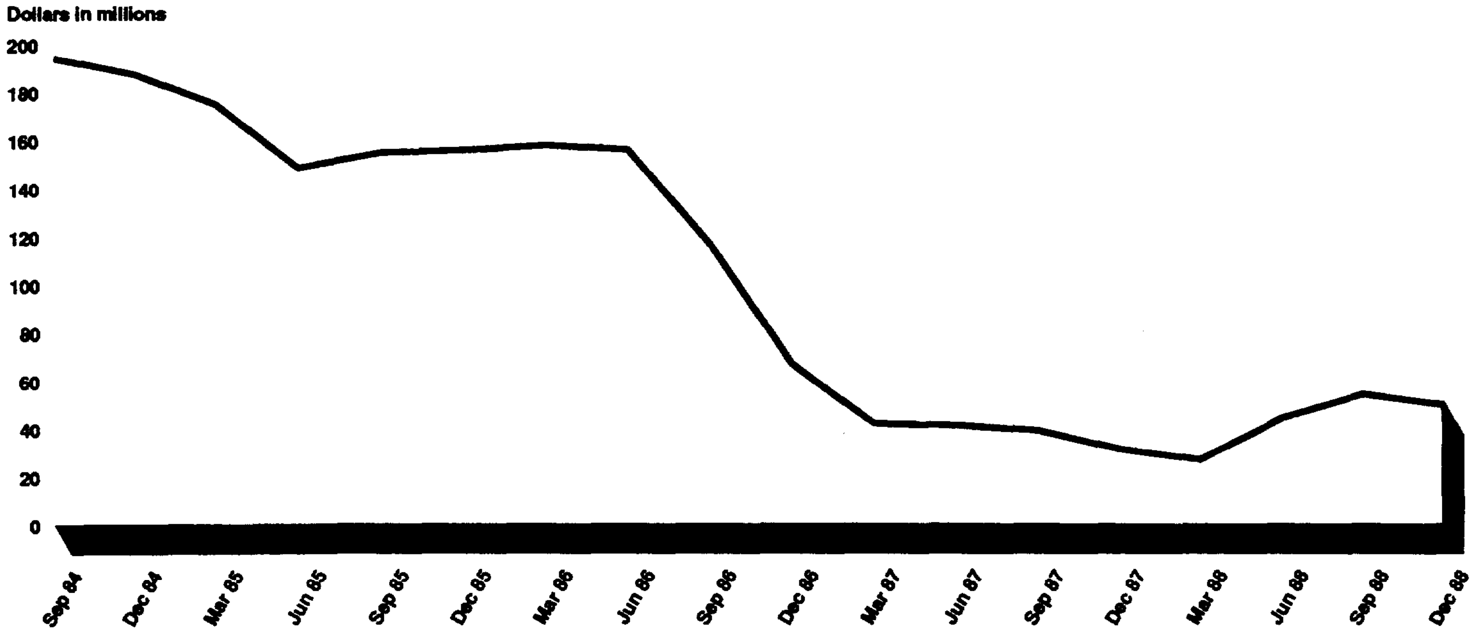
Figure I.2: Monthly Unreconciled Differences in Customs' Automated Commercial System—Reported Collections vs. Reported Deposits, September 1987 Through February 1989



Figures are for end of listed month

Customs officials at the National Finance Center stated that the unreconciled balance occurs, in their opinion, because an automated reconciliation between collections and deposits at the end of each month cannot be performed as a result of software limitations in ACS. For this report, we did not attempt to determine the exact nature of these limitations or their impact on the reconciliation process. Given the limitations of the system, it is impossible for us or Customs to determine at this time whether any money is, in fact, missing. Customs officials also stated that their inability to reconcile recorded collections with deposits is not new and actually predates the establishment of the Financial System module in 1984. Since fiscal year 1984, the unreconciled balance at the end of each fiscal year has ranged from a high of about $194 million in fiscal year 1984 to a low of about $38.9 million in fiscal year 1987. This amount began to grow again in fiscal year 1988 and is now in the $50 to $55-million range. Figure I.3 shows the cumulative unreconciled differences, as reported on the Customs Statement of Accountability reports, from September 1984 through December 1988.

Figure I.3: Quarterly Unreconciled Differences in Customs' Automated Commercial System—Reported Collections vs. Reported Deposits, September 1984 Through December 1988



Figures are for end of listed month

Recognition of Control Problems

Customs and Treasury officials have been aware of internal control weaknesses in Customs' revenue collection process and the ACS Financial System module since at least 1987. Several reports have addressed internal control problems within Customs. In February 1987, we reported weaknesses in ACS internal controls identified during 1985 and 1986. In 1987 and in 1988, Treasury reported, in its Federal Managers' Financial

Integrity Act report, internal control weaknesses in Customs' accounting systems and revenue collection process. A Customs Internal Affairs draft report we obtained in January 1989 stated that Customs management does not have enough assurance that all funds received by Customs are properly accounted for and deposited into the U.S. Treasury.

In our 1987 report to the Commissioner of Customs, we identified several weaknesses in ACS' internal controls. Although at the time we found no actual cases of fraud, waste, or abuse involving ACS, we stated that such incidents could occur as ACS becomes more complex and an integral part of Customs' operations. Among other things, we found that individuals had access to ACS functions beyond those necessary to perform their assigned jobs. This control weakness would allow individuals to commit fraud and cover up or remove evidence of their actions. We also found that plans to test ACS software were not adequate, thus increasing the risk that the system would contain serious errors.

The Commissioner of Customs, in officially responding to our draft report, agreed that ACS had weaknesses and he stated that he planned to take corrective action. However, he cited ACS as a resounding success and questioned the significance of internal control weaknesses because we did not identify any actual cases of fraud, waste, or abuse involving ACS. The Commissioner agreed that all software testing should be performed under formal test plans and stated that a study was being undertaken in order to improve the effectiveness and efficiency of Customs' testing process. After the report was issued, the Deputy Assistant Secretary for Information Systems, Department of the Treasury, said that corrective actions were already being taken on the issues cited in our report. However, we have not yet verified the effectiveness of these actions.

In Treasury's Fiscal Year 1987 Federal Managers' Financial Integrity Act report, the Secretary stated that Customs' accounting system was not in compliance with the Comptroller General's Standards for Accounting and Internal Controls. In December 1988, the Secretary of the Treasury reported to the President and the Congress that "the Department has strong reservations concerning the effectiveness of internal controls within the U.S. Customs Service." The report cited, as a material weakness, Customs' inability to reconcile collections to deposits with any supported detail.

Customs Internal Affairs also released a draft audit report in January 1989 that identified internal control weaknesses. The report concluded that Customs management does not have enough assurance that all funds received by Customs' collection points are deposited intact and properly credited to Treasury. The report further identified approximately 4,835 deposit differences between Customs' and Treasury's accounting records from 1981 through 1987 that have not been researched or resolved by Customs. The total value of the differences was estimated by Customs to be about $173 million, as of March 1988. The report noted, however, that all but 41 of these differences occurred prior to the establishment of the National Finance Center in 1985. The 41 newer items were valued by Customs at approximately $750,000.

Recent Customs Actions to Correct Weaknesses

As a result of these and other prior studies, Customs management initiated an assessment of the situation and concluded in a December 1988 briefing report that the process of collection, deposit, and reconciliation is and has been "in total disarray" since at least 1985. The report also pointed out that the commitment of resources to solve the problem had not received the priority commensurate with the magnitude of the systems' deficiencies. The assessment concluded that without the necessary management attention and adequate resources, the financial accounting systems will not meet required federal standards and will continue to result in material weaknesses that must be reported under the Federal Managers' Financial Integrity Act.

Senior Customs officials in the financial management and data processing functions stated that corrections to these weaknesses have been long overdue and that action is now being taken to correct the deficiencies. The acting director at the National Finance Center stated that establishing internal controls is a top priority. In October 1988, the acting director formed a task force to supplement the internal affairs study and determine the causes of the internal control problems. The purpose of the task force was to assess the scope of internal control issues associated with the collection and deposit process.

The task force identified numerous procedural and ACS shortcomings in the revenue collection and accounting processes and developed 30 recommendations to correct them. For example, one of these recommendations directs ports to begin requiring their depository banks to prepare and return receipts for all deposits to the originating port. The purpose of this recommendation is to provide for an internal control to reduce the vulnerability of deposits not reaching the bank, a vulnerability exploited in the Port of Chicago theft. The acting director of the

National Finance Center stated that plans have been developed to implement some of these recommendations immediately. However, the acting director stated that actions on these plans would be limited because of the lack of available resources at the National Finance Center and because some solutions require the use of resources beyond the acting director's control.

In March 1989, a new task force was formed by the ACS Steering Committee to begin development on the ACS collection and deposit reconciliation enhancements that were identified in January 1987. We were also told that the task force would begin studying the collection and deposit reconciliation problems and developing solutions to address these problems. Customs officials stated that an additional objective was to determine resource needs to implement the task force's solutions.

Objective, Scope, and Methodology

On February 10, 1989, the Chairman of the Subcommittee on Oversight, House Committee on Ways and Means, asked us to determine whether Customs has adequate controls in place to ensure that all revenues collected are deposited in the U.S. Treasury. Since similar information was also being gathered under a request from the Chairman of the Subcommittee on Treasury, Postal Service, and General Government, Senate Committee on Appropriations, we agreed with both Subcommittee offices to provide this interim report summarizing selected information we had obtained to date. We will be reporting later on Customs' revenue collection process and the role that ACS plays in this process.

To obtain this information, we analyzed documents relating to the development and current status of the ACS Financial System module. We reviewed the Department of the Treasury's Federal Managers' Financial Integrity Act reports, Customs Internal Affairs and management assessment reports, Customs' collections and deposit reports, and financial Statements of Accountability as reported to Treasury.

To obtain Customs' view of the ACS Financial System module and the revenue collection process, we interviewed officials at Customs headquarters in Washington, D.C., and its National Finance Center in Indianapolis, Indiana. We also interviewed Customs employees involved in the revenue collection process at the ports of Los Angeles and San Francisco, California; Chicago, Illinois; and Baltimore, Maryland. In addition, we discussed the revenue collection process with Treasury's Financial Management Service personnel in Washington, D.C., and Hyattsville, Maryland.

We discussed the contents of this report with Customs officials and have included their comments where appropriate. Our work was performed in accordance with generally accepted government auditing standards, from October 1988 to March 1989.

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