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Internal Control Weaknesses In Customs
Revenue Collection Process

Statement of
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Before the Subcommittee on Oversight
Committee on Ways and Means
House of Representatives



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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the internal controls Customs uses to account for the revenues it collects on imported merchandise. In fiscal year 1988, it collected about \$17.5 billion in duties, tariffs, and taxes. My testimony is based on an interim report¹ we issued to you last Tuesday. The information we have gathered raises serious questions about the adequacy of Customs' manual and automated internal controls.

Two problems highlight the seriousness of the situation. First, during the last two and one half years over \$4.2 million was stolen in two separate frauds, without being detected by these controls. Second, Customs is unable to reconcile recorded collections with recorded deposits; as of February 1989, collections exceeded deposits by the cumulative amount of about \$54 million.

Because our work is preliminary, we have not yet determined the root causes of these internal control problems. Although Customs and Treasury officials have been aware of these problems since at least 1987, they have taken little corrective action. However, in the last few months top management at Customs has been spurred into action as a result of a December 1988 management assessment report, which concluded that the revenue collection process ". . . is and has been in total disarray since at least 1985." As a

¹CUSTOMS AUTOMATION: Internal Control Weaknesses In Customs' Revenue Collection Process (GAO/IMTEC-89-50, Apr. 11, 1989).

result, Customs formed a task force last month to analyze the problems and develop solutions.

OVERVIEW OF REVENUE COLLECTION PROCESS

Before I discuss these problems in more detail, I would like to take a couple of minutes to describe the process Customs follows to collect and account for revenues. At the heart of the process is the Automated Commercial System. This system provides automation support for the revenue collection process within Customs.

When merchandise valued over \$1,000 is imported into the United States, brokers and importers must file documents with Customs describing the merchandise. Within 10 days after Customs releases the merchandise, brokers and importers must pay all duties, tariffs, and taxes.²

When Customs officials at U.S. ports receive the documents and payments, data from the documents and the amount of each payment are entered into ACS as a collection. Later in the day, cashiers total all checks and cash received and enter the total into ACS as the amount deposited for that day. Each day, cashiers are required to compare the total collections entered for each terminal with the total daily deposits. According to Customs, if the two totals

²A 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.

do not agree, the terminal can not be closed out until the discrepancies are resolved.

Deposit packages containing the day's collections are prepared and sent to a commercial or Federal Reserve Bank. (See chart 1.) Deposit tickets confirming the receipt of funds are forwarded by the banks to Customs National Finance Center in Indianapolis. Banks later confirm the actual amount of funds received and prepare adjustments for such items as shortages or counterfeit bills. Data on these deposits and adjustments are then forwarded to the National Finance Center and Treasury.

By the eighth working day after the end of each month, Customs sends a Statement of Accountability to Treasury, summarizing total collections and total deposits. About a month later, Treasury sends a Statement of Differences to Customs, detailing any differences between the deposits reported by the banks and the deposits reported by Customs.

CONTROL WEAKNESSES:
THEFTS OF \$4.2 MILLION

To illustrate the weaknesses in Customs' internal controls, I would like to describe in more detail the two frauds mentioned earlier. These frauds resulted in the theft of about \$4.2 million in revenues, and were perpetrated for extended periods of time without detection by Customs' internal controls.

One of these frauds occurred at the Port of Chicago. It involved 10 thefts totaling over \$3.4 million and extended over a 2-month period from May 26 to August 2, 1988. Information was entered into ACS showing that collections were made and deposited in a bank. These deposits had, in fact, been given to a courier to take to the Federal Reserve Bank, but the deposits never reached their intended destination.

Customs officials stated that these thefts were not detected until about 2 months after the initial May 26 theft when the courier company became suspicious of one of its employees. The company then notified the Chicago Police Department, which in turn, contacted port officials on August 4, 1988 to investigate the alleged thefts. According to Customs officials, it took 11 days to research the files to identify the missing deposits.

These Chicago thefts were not detected by Customs' controls because ports do not receive copies of confirmed deposit tickets from banks; instead, tickets are sent to Customs National Finance Center. However, the center does not use the deposit tickets to verify that deposits were received; it relies on bank deposit data from Treasury, but the center does not receive this data until about 2 months after the deposit date.

In the other fraud, a former Customs employee at the Los Angeles International Airport was recently convicted on 21 counts of embezzling about \$840,000 in government funds during a 1-year period. This employee was responsible for preparing deposit

documents and forwarding collection data for input into ACS. The employee did not deposit funds received. Instead, the employee destroyed and, in some cases, altered serially numbered forms, which are used to record the collection of duties and taxes from arriving passengers. These numbers are entered into ACS with the amount collected so that any missing documents can later be identified.

According to an Internal Affairs investigation, error listings were not being researched to determine why certain serially numbered documents were missing. Instead of basic internal controls detecting the thefts, Customs officials said that the thefts were discovered when they received an inquiry from a former passenger asking why Customs never cashed the passenger's check for a duty payment.

CONTROL WEAKNESSES:
INABILITY TO RECONCILE

Another major indication of internal control weaknesses is Customs' inability to reconcile collections recorded in ACS with deposits. As stated earlier, Customs must send a Statement of Accountability to Treasury each month to summarize collections and deposits and account for any differences. However, because Customs has been unable to reconcile the two amounts for the last several years, it has had to derive a figure--that is, a "plug" figure--so collections and deposits balance. To maintain accountability, this figure must be carried forward each month. Customs' records show that this "plug" figure actually represents a cumulative

unreconciled balance. This figure has always been necessary to account for recorded collections being greater than recorded deposits. As of February 28, 1989, this cumulative unreconciled balance was about \$54 million.

As you can see in chart 2, the unreconciled balance has been a long standing problem. Since fiscal year 1984, Customs has reported an unreconciled balance at the end of each quarter ranging from a high of about \$194 million to a low of about \$39 million. This amount began to grow again in fiscal year 1988 and is now in the \$50 to \$55 million range. Chart 3 shows, on a monthly basis, the growth in this cumulative unreconciled amount, which ranged from about \$27 million to \$61 million from September 1987 through February 1989.

Customs officials stated that their inability to reconcile recorded collections to deposits is not new and actually predates the establishment of ACS in 1984. They also stated that the unreconciled balance continues because software limitations in the system prevents an automated reconciliation between collections and deposits. Given these limitations, it is impossible to determine, at this time, whether any money is, in fact, missing.

RECOGNITION OF CONTROL PROBLEMS

The Customs Service has been aware of these internal control problems for quite some time:

- In February 1987, we reported two major weaknesses in ACS internal controls: (1) individuals had access to ACS functions beyond those necessary to perform their jobs, and (2) software test plans were not adequate to ensure that serious software errors would be detected.

- In 1987 and in 1988, Treasury reported to the President and the Congress, in its Federal Managers' Financial Integrity Act reports, that Customs' accounting systems and revenue collection process had material internal control weaknesses.

- A Customs Internal Affairs report in December 1988 cited significant internal control problems. It concluded that Customs does not have enough assurance that all funds received by Customs are deposited and properly credited to Treasury.

- In October 1988, the acting director of Customs National Finance Center formed a task force to supplement the Internal Affairs study. The task force identified the causes of several internal control weaknesses and developed 30 recommendations to correct them.

As a result of these and other studies, Customs management assessed the situation and concluded in a December 1988 report that the revenue collection process has significant internal control problems 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 system's 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.

In summary, Mr. Chairman, our preliminary work has disclosed some long standing serious weaknesses in controls over the collection and deposit of revenues. Because these controls are supposed to account for \$17.5 billion per year, top management at Customs must ensure that the root causes of these weaknesses are identified and resources committed to their prompt correction.

Mr. Chairman, this concludes my prepared statement. I will be happy to respond to any questions at this time.

Chart 1: Overview of Customs Revenue Collection Reporting Process

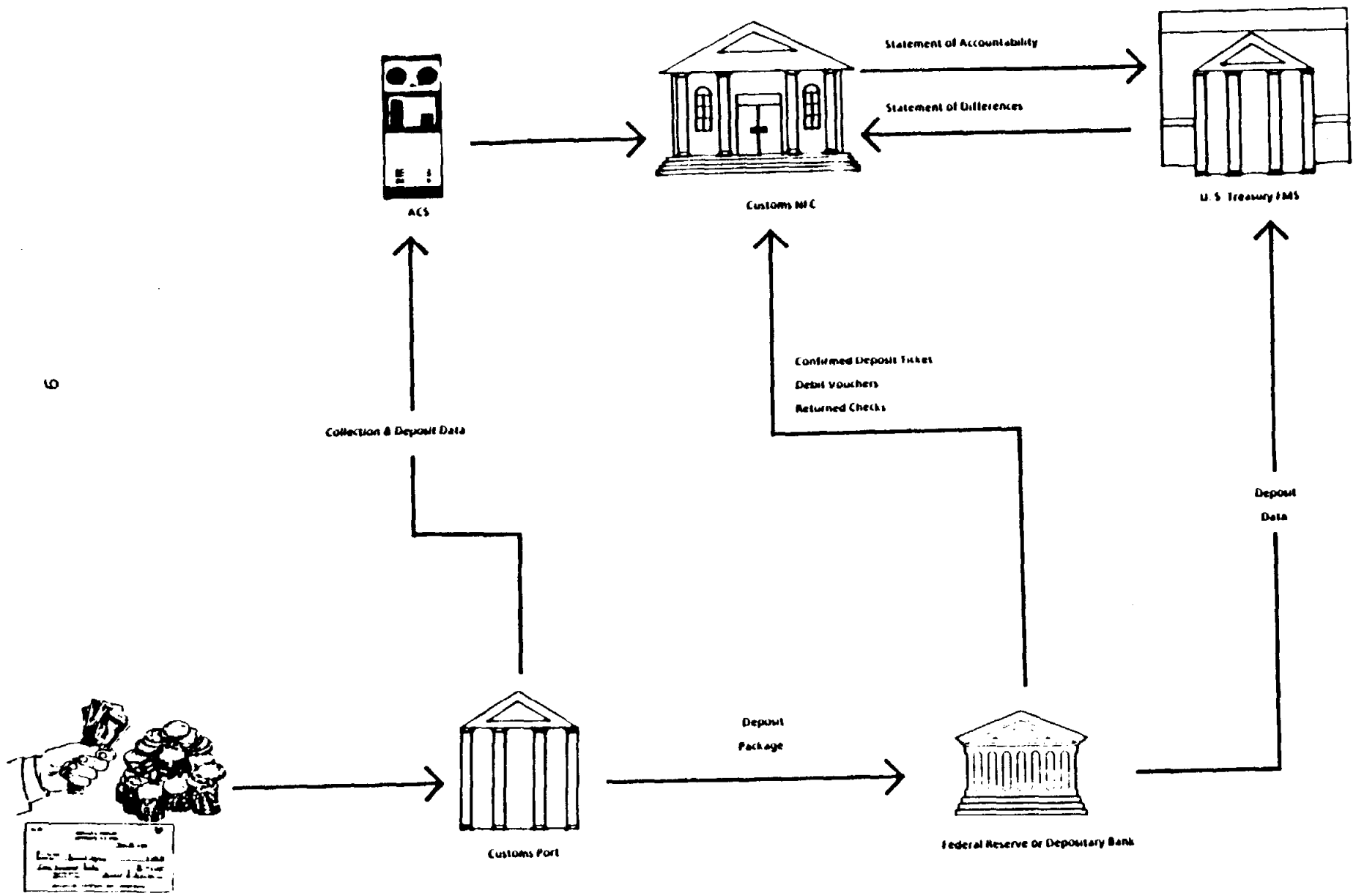
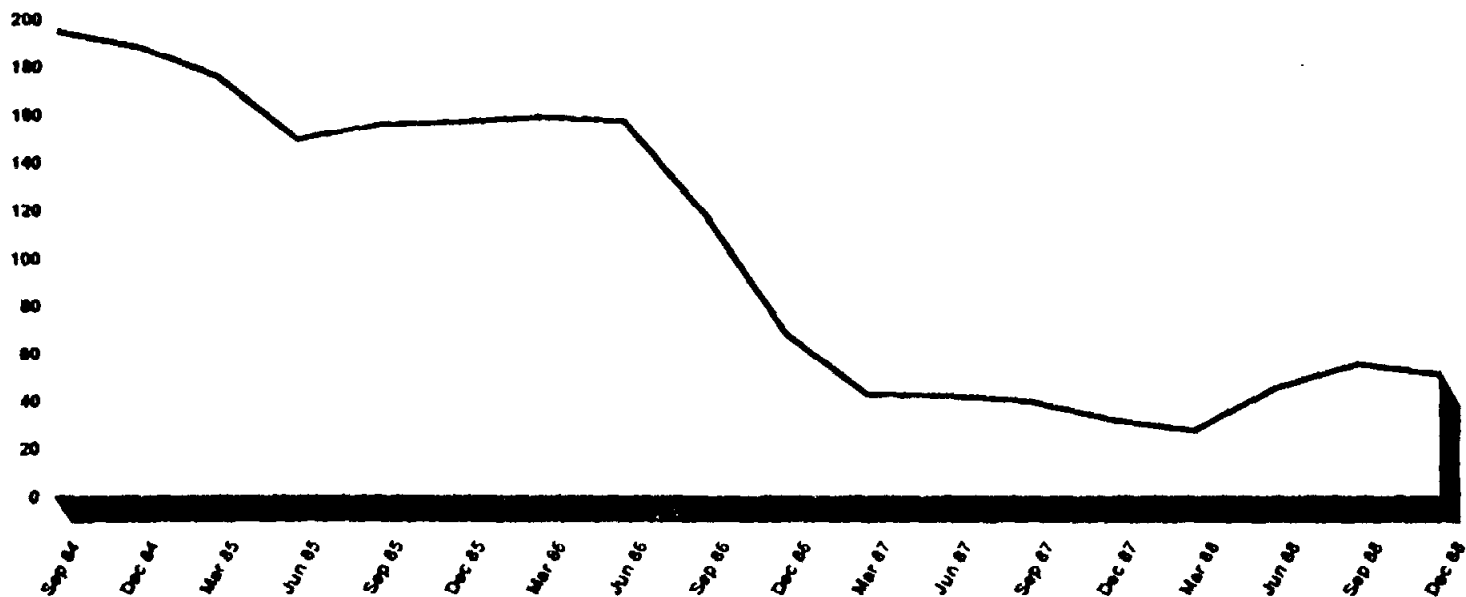


Chart 2: Quarterly Unreconciled Differences in Customs' Automated Commercial System--Reported Collections vs. Reported Deposits, September 1984 through December 1988

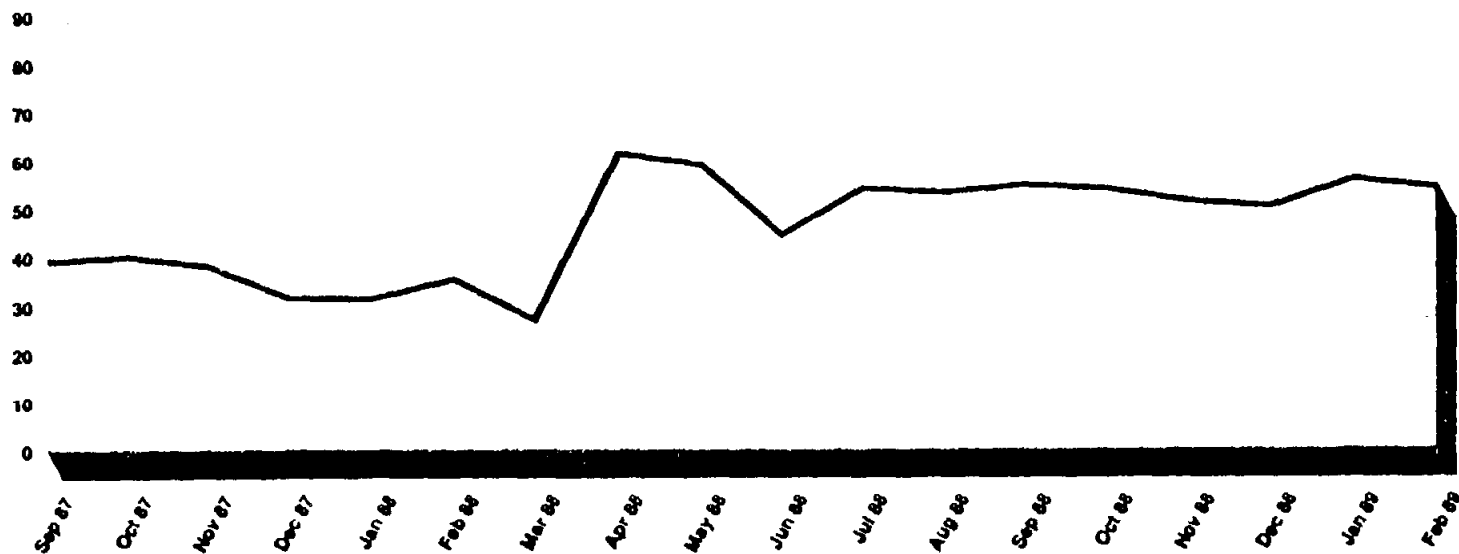
Dollars in millions



Figures are for end of listed month

Chart 3: Monthly Unreconciled Differences in Customs' Automated Commercial System--Reported Collections vs. Reported Deposits, September 1987 through February 1989

100 Dollars in millions



Figures are for end of listed month