Department of Homeland Security
Office of Inspector General

Efficacy of Customs and Border Protection's Bonding Process

OIG-11-92

June 2011

Office of Inspector General

U.S. Department of Homeland Security
Washington, DC 20528

Homeland Security

June 27, 2011

Preface

The Department of Homeland Security (DHS) Office of Inspector General (OIG) was established by the *Homeland Security Act of 2002* (Public Law 107-296) by amendment to the *Inspector General Act of 1978*. This is one of a series of audit, inspection, and special reports prepared as part of our oversight responsibilities to promote economy, efficiency, and effectiveness within the department.

This report addresses the efficacy of U.S. Customs and Border Protection's bonding processes. It is based on interviews with employees and officials of relevant agencies and institutions, direct observations, and review and testing of applicable documents.

The recommendations herein have been developed to the best knowledge available to our office, and have been discussed in draft with those responsible for implementation. We trust this report will result in more effective, efficient, and economical operations. We express our appreciation to all who contributed to the preparation of this report.

Anne L. Richards
Assistant Inspector General for Audits

Table of Contents/Abbreviations

Appendices

Abbreviations

ACE	Automated Commercial Environment
ACS	Automated Commercial System
AD	antidumping
CBP	U.S. Customs and Border Protection
Commerce	Department of Commerce
CV	countervailing
DHS	Department of Homeland Security
FY	fiscal year
GAO	Government Accountability Office
OIG	Office of Inspector General
SEB	single entry bond
STB	single transaction bond

OIG

Department of Homeland Security
Office of Inspector General

Executive Summary

U.S. Customs and Border Protection have responsibility for protecting revenue collection and enforcing trade compliance by the use of bonds. In fiscal year 2010, Senator Charles Grassley expressed concerns about alleged deficiencies in U.S. Customs and Border Protection's revenue collection program. This is the second of a series of audits conducted to address Senator Grassley's concerns. Our audit objective was to determine the efficacy of U.S. Customs and Border Protection's process for determining and applying bonds in sufficient amounts. These bonds serve as insurance for the agency to cover importer duties, fees, and taxes should the importer fail to pay revenues as required on goods brought into the United States.

Although U.S. Customs and Border Protection has strong controls over continuous bonds, it does not have adequate controls over the single transaction bond process, and its method for determining and applying single transaction bonds is ineffective. We estimate that approximately $8 billion of $12 billion in single transaction bonds for importer/broker entries accepted by U.S. Customs and Border Protection during fiscal year 2009 contain errors that may result in noncollection. Additionally, our analysis shows $1.5 billion at risk of loss for imports subject to other government agency requirements. We attribute this condition to U.S. Customs and Border Protection's need for—

- Oversight for the single transaction bond process;
- A risk-based management approach to reduce potential revenue loss associated with bonds; and
- An automated single transaction bonds process.

Consequently, U.S. Customs and Border Protection's ability to meet its strategic goals of revenue collection and enforcement using single transaction bonds is jeopardized.

U.S. Customs and Border Protection officials concurred with all the recommendations. Appendix B contains written responses to the recommendations from U.S. Customs and Border Protection.

Background

U.S. Customs and Border Protection (CBP) is responsible for collecting import duties, taxes, and fees. In fiscal year (FY) 2010, imports totaled approximately $2 trillion, and CBP collected approximately $32 billion in duties, taxes, and fees. CBP has the authority to require bonds from parties that import merchandise into the United States.[1] A bond is a contract between a principal and a surety, with CBP serving as the beneficiary. Bonds serve as an insurance policy, protecting CBP from revenue loss when importers fail to fulfill their financial obligations. The assessment of liquidated damages against a bond also serves to promote compliance with laws and regulations.

CBP has two primary types of bonds: continuous and single transaction. Importers who have a large number of entries or imports during a given year usually obtain continuous bonds, which have a term of 1 year, automatically renew annually, and remain valid until terminated by the surety or the principal. The minimum continuous bond amount is the greater of $50,000 or 10% of the total taxes and fees paid in the previous 12-month period. The Debt Management Branch within the Revenue Division of the Office of Administration oversees and administers the continuous bond program.

Single transaction bonds (STBs) can serve as security for individual shipments or as additional collateral in conjunction with continuous bonds. They cover only the transaction for which they were written. Port Directors in the Office of Field Operations have the authority to require additional security in the form of an STB, and have the responsibility to set the bond amount and to validate its accuracy and completeness. The STB amount is generally one to three times the total entered value of the merchandise plus duties, taxes, and fees, depending on the revenue risk. CBP does not have a centralized office responsible for overseeing and administering the STB program.

In 2002, CBP made revenue a Priority Trade Issue, with a focus on improving revenue collection, trade compliance, and trade facilitation. CBP prepares an annual Revenue Priority Trade Issue plan that assesses risks, threats, and vulnerabilities to revenue collection. The plan also establishes annual priorities for reducing revenue risk and includes milestones, due dates, and performance measurements. The plan identifies bonds as a risk mitigation tool

[1] Title 19, United States Code, Section 1623.

for various programs. In 2009, CBP created a Revenue Risk Working Group to identify ways CBP could better ensure that revenue was adequately secured.

U.S. law authorizes the imposition of antidumping/countervailing (AD/CV) duties to remedy the adverse impact of unfair foreign trade practices on domestic industries.[2] The United States Department of Commerce (Commerce) imposes AD/CV duties on merchandise imported into the United States at less than its fair value (dumping) or that is subsidized by foreign governments (countervailing). Commerce is responsible for determining if dumping or countervailing has occurred, and the U.S International Trade Commission is responsible for determining whether a domestic industry is materially injured, or threatened with material injury. For CV duties, a "material injury" determination is required only for merchandise imported from a "Subsidies Agreement Country," as defined by 19 USC § 1671(b). Once the required determinations are made, Commerce directs CBP to collect duties at a rate equal to the amount by which the normal value of the merchandise exceeds the export price (antidumping) or an amount equal to the net subsidy (countervailing).

If the duty rate paid at the time of import is higher than the final duty rate, CBP refunds money to the importer. If the duty rate paid at the time of import is lower than the final duty rate, CBP issues a supplemental bill to the importer. The Government Accountability Office (GAO) found that the entire process takes an average of 3.3 years.[3] By the time Commerce directs CBP to retrospectively collect the final duty amount on an entry, importers may be unwilling or unable to pay or may have disappeared altogether, resulting in significant revenue loss to the government.

Results of Audit

CBP Does Not Have Adequate Controls Over Its Single Transaction Bond Process

Although CBP has strong controls over continuous bonds, it does not have adequate controls over the STB process. CBP cannot identify the number of STBs, has inaccurate and incomplete bonds, does not maintain and review bonds as required, underutilizes its bond authority, and does not

[2] The *Tariff Act of 1930*, as amended, authorizes the imposition of these duties. AD duties are authorized by 19 U.S.C § 1673 and CV duties are authorized by 19 U.S.C § 1671.
[3] *Antidumping and Countervailing Duties: Congress and Agencies Should Take Additional Steps to Reduce Substantial Shortfalls in Duty Collection* (GAO 08-391), March 2008.

adhere to its monetary guidelines for entries with other government agencies requirements. We attributed these conditions to CBP's need for—

- Oversight over the STB process to ensure that personnel apply bonding policies and procedures sufficiently, appropriately, and consistently;
- A risk-based management approach that includes identification, assessment, and mitigation of the risk of revenue loss associated with bonds; and
- An automated STB process.

Failure to establish adequate controls over the STB process may result in revenue loss from fraud, waste, or mismanagement.

Bond Universe

CBP cannot identify the number of STBs because of limitations in the Automated Commercial System (ACS), which is used to report entry data. Although the Automated Commercial Environment (ACE), CBP's system of record, has the capability to enter bond information for multiple bonds, CBP does not currently require importers to file all entries in ACE. ACS has only one field for bond coverage, and it cannot record bond information for imports that require both a continuous bond and an STB. In such cases, the system defaults to a continuous bond, thereby not capturing actual revenue exposure on high-risk imports. This limitation creates a challenge when CBP attempts to collect past-due revenue. Since ACS does not contain any STB information, CBP's Debt Collection Division must manually call each port to determine if STBs exist. The port conducts a manual search to identify STBs and forwards the information to the Debt Collection Division. This labor-intensive practice hinders CBP's debt collection process and reporting.

CBP has attempted to mitigate the system limitations by requiring ports[4] to record general STB information for AD/CV entries using the ACS notes section. However, our review showed that ports do not consistently follow this direction. Two out of nine importers with both continuous bonds and STBs for their AD/CV entries in ACS did not have system notes with the required STB information.

[4] CBP Memorandum, Procedures for AD/CVD Entries with a Single Entry Bond, September 26, 2003; CBP Memorandum, Single Entry Bond (SEB) ACS Note Requirement, February 24, 2004.

Inaccurate and Incomplete Bonds

CBP has experienced significant losses from weaknesses in bond validation and approval controls. From FY 2007 through FY 2010, CBP has written off $46.3 million[5] in revenue because of inaccurate, incomplete, or missing bonds.

Although CBP guidance exists regarding STB approval and validation, ports do not consistently apply it. Federal regulations provide specific information that STBs must include prior to CBP's approval.[6] We reviewed a statistical sample of FY 2009 STBs[7] totaling $8.3 million. Our review showed that 230 of 382 (60%) of the STBs, totaling approximately $5.3 million, had one or more errors that may impact CBP's ability to recover revenue, if necessary. CBP should have rejected these bonds because of inaccuracies and incompleteness.

Included in the $5.3 million noted above, STBs totaling approximately $1.1 million had major omissions or errors such as missing signatures and inaccurate transaction numbers, which may create collection challenges. Based on these testing results, we conclude that approximately $8 billion of the $12 billion in STBs accepted by CBP during FY 2009 contain errors that may result in noncollection.

Bond Maintenance

CBP does not always maintain original STB documents at the ports. Of the 71 ports responsible for processing STB entries, our structured interview questionnaire showed that 18% (13) do not maintain copies of all the bond files and/or allow brokers to maintain the STBs. Federal regulation requires that Port Directors retain copies of all approved bonds at the port unless otherwise directed in writing by the Director of the Border Security and Trade Compliance Division.[8]

If CBP relies on the broker to ensure a bond's existence, it has no assurance that the broker can produce the bond when needed for collection purposes. Additionally, there is a potential for collusion between the broker and the importer. For example, in some

[5] Write-offs include losses from continuous bonds accepted prior to the centralization of the CBP program in Indianapolis.
[6] 19 CFR § 113.21 (2010).
[7] Because of scope limitations in identifying the total STB universe, we limited our testing to FY 2009 importer/broker entries secured exclusively by STBs.
[8] 19 CFR § 113.15 (2010).

instances, it may be cheaper for the importer to pay liquidated damages for failure to produce the bond document than to purchase an STB and attach collateral.

<u>Underutilization of Bond Authority</u>

Port Directors do not consistently exercise their authority to require additional security on high-risk imports when reasonable evidence exists showing revenue risk. Port Directors do not always require STBs for high-risk practices such as entries with undervalued merchandise, misclassifications resulting in higher duty rates, or liquidated damages and penalties assessed for prior noncompliance with laws, regulations, or policies. Port Directors should require STBs in instances where the continuous bond does not adequately protect against noncompliance.

Federal regulation gives CBP Port Directors the authority to require additional security if accepting a transaction secured by continuous bond would put the revenue at risk or otherwise hamper the enforcement of Customs laws or regulations.[9] Responses to our structured interview questions of Port Directors indicated that 85% of the ports do not perform any type of revenue risk analysis to determine the need for an STB. When the Port Directors recognize the need for additional security, approximately 72% of the ports rarely or never require an STB. Port personnel stated that CBP guidance provided to them regarding how to estimate the actual level of revenue risk and to document the risk is not clear. Other CBP personnel expressed concerns that STBs have a negative impact on trade facilitation and may cause some importers financial hardships because of the additional cost of STBs and the collateral required by many sureties.

<u>Risk-Based Bonding</u>

CBP has not yet developed a risk management process that effectively uses bonds to mitigate the revenue loss on high-risk imports, such as AD/CV. AD/CV activities of high-risk imports have resulted in significant revenue loss over the past several years. AD/CV write-offs from FYs 2007 through 2010 total $48 million and represent 51% of the total charge-offs for these years. As of June 2010, CBP had approximately $1 billion in AD/CV past-due bills that is at risk of revenue loss because of inadequate security.

[9] 19 CFR § 113.13(d) (2010).

We reviewed 4,559 past-due AD/CV duty bills as of FY 2010 totaling $145.8 million from 13 importers. These importers had continuous bonds and also paid AD/CV duties in cash at the time of importation. However, following the completion of Commerce's required administrative review, AD/CV duty rates on these shipments increased significantly, requiring CBP to issue supplemental bills for additional AD/CV duties. With only $2 million in current continuous bond coverage (approximately 1.5% of the outstanding bills), CBP will not collect $143 million in unsecured revenue.

CBP can improve revenue collection by developing a risk-based bonding approach that considers continuous bonds and STBs. While we acknowledge that CBP cannot eliminate all risk, it can improve revenue collection by developing guidelines that evaluate the revenue risk of imports and delineate risk levels that would require additional bonding.

CBP recognizes the need to improve revenue collection for high-risk imports. Despite its legal failure to implement an enhanced continuous bond requirement for AD/CV entries, it continues to consider other options. It developed an FY 2011 annual Revenue Priority Trade Issue Plan and established the Revenue Risk Working Group in 2009 to identify high-risk revenue areas. Although it is moving in the right direction, CBP needs to continue to take action to reduce and mitigate revenue risk for high-risk revenue areas, especially AD/CV entries.

Nonadherence to Monetary Guidelines for Entries With Other Agency Requirements

CBP does not follow its monetary guidelines for setting STB amounts for merchandise, such as chemicals, food, or drugs for human use and consumption. Other government agency requirements could include redelivery requests by the Environmental Protection Agency and the Food and Drug Administration for merchandise that poses a risk to the public health and safety. Entry of merchandise with other government agency requirements has a higher risk for liquidated damages than other entries. These entries can result in significant losses because the merchandise may be subject to recall because of potential public health and safety threats. CBP is required to set STBs in amounts no less than three times the total entered value of such merchandise.

From our statistical sample of FY 2009[10] STBs totaling $8.3 million, we tested bond sufficiency for merchandise subject to other government agency requirements. Our testing showed 31 insufficient STBs totaling $623,855 that were insufficient by approximately $1 million. The average shortfall on the STBs was approximately $17,000.

Based on our testing, we project that CBP should have required approximately $1.5 billion more in STBs during FY 2009 to cover risk of imports subject to other government agency requirements. Failure to require sufficient security on these higher-risk imports may result in significant loss if importers fail to comply with health and safety standards and CBP has to recall the merchandise.

Recommendations

We recommend that Customs and Border Protection's Assistant Commissioners—

Recommendation #1: Appoint a centralized office with the responsibility for developing and implementing single transaction bond policy, reporting on activities, and monitoring results.

Recommendation #2: Consider automating the single transaction bond process to provide enhanced tracking ability and control over these bonds.

Recommendation #3: Develop formal policies and procedures for the validation, approval, sufficiency, and storage processes for single transaction bonds.

Recommendation #4: Improve revenue risk management by developing a risk-based bonding methodology for use on high-risk revenue imports that incorporates continuous bonds and single transaction bonds.

Management Comments and OIG Analysis

We obtained written comments on the draft report from CBP's Assistant Commissioner, Officer of Internal Affairs. We included a copy of the management comments in their entirety in Appendix B. The following is an evaluation of CBP's official response.

[10] Because of scope limitations in identifying the total STB universe, we limited our testing to FY 2009 importer/broker entries secured exclusively by STBs.

Management Response on Recommendation #1

CBP concurred with this recommendation and has already begun delineating the roles and responsibilities among offices. Centralization will focus on two main program areas: bond administration and bond policy, which will include risk-based assessments and analysis for determining when an STB should be used as additional security.

OIG analysis: We consider CBP's proposed action responsive to the recommendation and consider the recommendation resolved. However, it will remain open until CBP provides evidence to show how the centralized process works in relation to policy development, reporting, and monitoring of the STB process.

Management Response on Recommendation #2

CBP concurred with this recommendation and has incorporated the requirement for bond automation into the ACE Cargo Release requirements.

OIG analysis: We consider CBP's proposed action responsive to the recommendation and consider the recommendation resolved. However, it will remain open until we receive evidence showing that the ACE Cargo release requirements properly address STB automation. CBP should also provide a deployment schedule for the new capability.

Management Response on Recommendation #3

CBP concurred with this recommendation and will review and update policies.

OIG analysis: We consider CBP's proposed action responsive to the recommendation and consider the recommendation resolved, but it will remain open until we receive copies of the revised policies that adequately address problems identified during the audit.

Management Response on Recommendation #4

CBP concurred with the recommendation and will continue working on the development of a risk-based bonding methodology for high-risk imports that considers the use of continuous and single transaction bonds.

OIG analysis: We consider CBP's proposed action responsive to the recommendation and consider the recommendation resolved. However, it will remain open until we receive evidence showing that CBP has developed a risk-based bonding methodology that addresses high-risk imports and reduces revenue risk.

This report provides the results of our work to determine the efficacy of Customs and Border Protection's process for determining and applying bonds in sufficient amounts to cover importer duties, fees, and taxes should the importer fail to pay revenues as required on goods brought into the United States.

We visited seven ports of entry that handle STBs, in Long Beach and San Francisco, CA; New York, NY; Newark, NJ; Chicago, IL; Miami, FL; and Baltimore, MD. At each site, we interviewed Port Directors and port personnel, and directly observed CBP's bonding process.

We judgmentally selected and reviewed 100 continuous bonds from a statistical sample of 383 active continuous bonds as of May 2010. We reviewed 382 STBs from a statistical a sample of 384 single-transaction-type entries from the universe of FY 2009 single-transaction-type entries in the Automated Commercial System. We tested continuous bonds and STBs for accuracy, completeness, and sufficiency of bond amounts. To compensate for system limitations in identifying entries with both a continuous bond and an STB, we reviewed bond coverage for 6,221 AD/CV open bills as of FY 2010 related to 21 importers.

We assessed the existence and implementation of CBP's policies and procedures for the bonding process. We used a structured questionnaire to interview 71 Port Directors responsible for the STB program. We interviewed officials and personnel from various offices and groups within CBP involved in the bond process, including the Office of Administration, Revenue Division of the Debt Management Branch; Chief Counsel at the National Finance Center in Indianapolis; the Revenue Risk Working Group; Office of International Trade; Office of Field Operations; and Management Inspections Division at Internal Affairs. We also met with personnel from the Department of Commerce to discuss risks involved with AD/CV cases.

We conducted our audit between March 2010 and January 2011 under the authority of the *Inspector General Act of 1978*, as amended, and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions.

1300 Pennsylvania Avenue NW
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U.S. Customs and
Border Protection

May 16, 2011

MEMORANDUM FOR ANNE L. RICHARDS
ASSISTANT INSPECTOR GENERAL FOR AUDITS
DEPARTMENT OF HOMELAND SECURITY

FROM: for Assistant Commissioner
Office of Internal Affairs
U.S. Customs and Border Protection

SUBJECT: Response to the Office of Inspector General's Draft Report Entitled, "Efficacy of Customs and Border Protection's Bonding Process"

Thank you for providing us with a copy of your draft report entitled "Efficacy of Customs and Border Protection's Bonding Process," and the opportunity to comment on the issues in this report.

The report contains four recommendations directed to U.S. Customs and Border Protection (CBP). A summary of CBP actions and corrective plans to address the recommendations is provided below:

Recommendation #1: Appoint a centralized office with the responsibility for developing and implementing single transaction bond policy, reporting on activities, and monitoring results.

CBP Response: Concur. CBP agrees that single transaction bond (STB) policy, reporting on activities and monitoring results should be centralized. We have already begun delineating the roles and responsibilities assigned among our various offices. However, bond policy encompasses two main program areas; one is bond administration, regarding the proper completion, application procedures and required minimum bond amounts. The other program area includes developing policies, risked based assessments and analysis needed to determine when STB's should be used as additional security to protect against revenue loss, and what the amounts should be. Both competencies are not located in any one office. We will proceed towards centralization with this as premise.

Completion Date: May 15, 2012

Recommendation #2: Consider automating the single transaction bond process to provide enhanced tracking ability and control over these bonds.

2

CBP Response: Concur. CBP has already considered automating the transaction bond process to provide enhanced tracking ability and control over these bonds. The process has been incorporated as part of the requirement in the Automated Commercial Environment (ACE) Cargo Release.

Completion Date: June 30, 2011

Recommendation #3: Develop formal policies and procedures for the validation, approval, sufficiency, and storage processes for single transaction bonds.

CBP Response: Concur. Current policies will be reviewed and updated in order to properly meet this recommendation.

Completion Date: May 15, 2012

Recommendation #4: Improve revenue risk management by developing a risk-based bonding methodology for use on high-risk revenue imports that incorporates continuous bonds and single transaction bonds.

CBP Response: Concur. CBP will continue with its FY 2011 Revenue Priority Trade Issue Plan to determine whether a continuous bond policy can be implemented that replaces the Enhanced Bond requirement (EBR) policy for Shrimp imports that CBP implemented to address the retrospective nature of the US Antidumping/Countervailing duty (ADCVD) system. The EBR was found to be inconsistent with World Trade Organization (WTO) guidelines, and rescinded. As a result of the WTO guidelines, CBP cannot raise importer bonds just based upon the "likelihood" that the Department of Commerce can retrospectively require importers to pay higher amounts of ADCVD duties than they originally deposited at entry. ADCVD duties have represented 87% of all uncollectible duty, most of which is the result of higher final ADCVD duty assessments. However, even though, under a retrospective ADCVD system, no finite bond amount can guarantee coverage of potential ADCVD final assessments, some form of combined continuous bond and single transaction bond policy for high risk importers may lessen the amount of uncollectible duty.

Completion Date: May 15, 2012

With regard to the sensitivity of the draft report, CBP did not identify any sensitive information that would require a "For Official Use Only" designation or warrant protection under the Freedom of Information Act. Technical comments to the draft report are provided in an attachment to this letter.

If you have any questions regarding this response, please contact me or have a member of your staff contact Ms. Ashley Boone, CBP Audit Liaison, at (202) 344-2539.

Attachment

Appendix C
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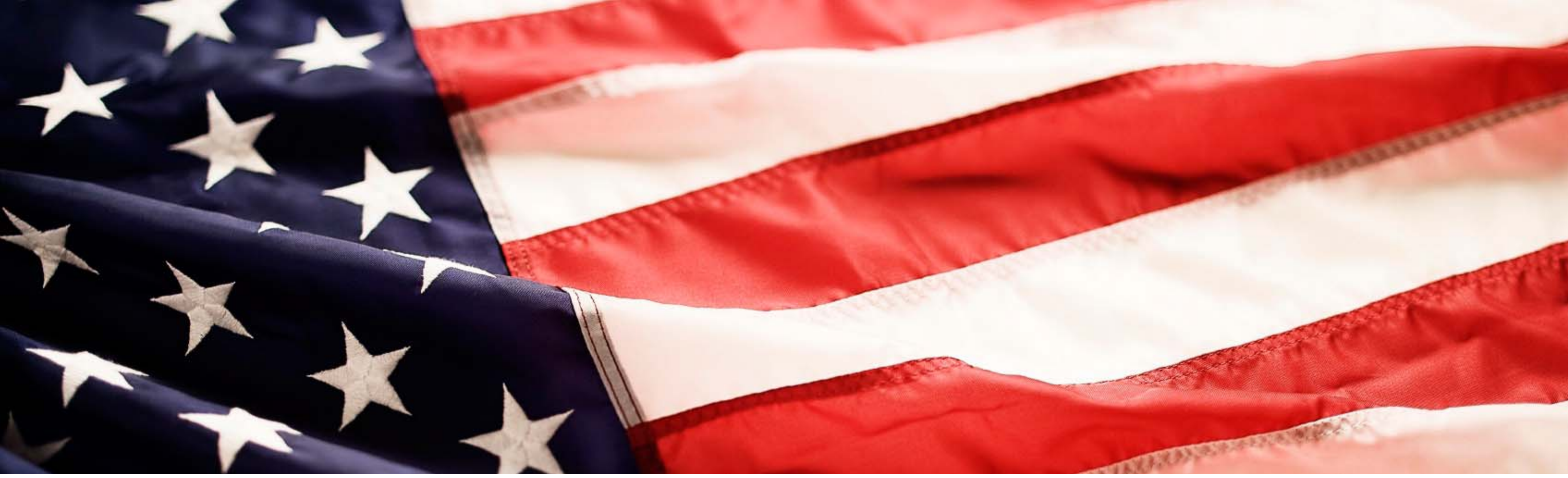

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