

# **Lack of Internal Controls Could Affect the Validity of CBP's Drawback Claims**





# DHS OIG HIGHLIGHTS

## *Lack of Internal Controls Could Affect the Validity Of CBP's Drawback Claims*

**December 12, 2019**

### **Why We Did This Review**

The *Department of Homeland Security Fiscal Year 2018 Independent Auditors' Report on Financial Statements and Internal Control over Financial Reporting* identified recurring CBP internal control deficiencies in drawback claims. Drawbacks are refunds of duties, taxes, and fees imposed on imported products later exported or destroyed. CBP management stated the timeframe for correcting deficiencies over drawback claims depends on successful implementation of information technology upgrades and legislative revisions. Our objective was to determine to what extent the identified control deficiencies impact drawback claims.

### **What We Recommend**

This report contains no recommendations because appropriate recommendations are contained in the annual Financial Statements and Internal Control over Financial Reporting reports.

#### **For Further Information:**

Contact our Office of Public Affairs at (202) 981-6000, or email us at [DHS-OIG.OfficePublicAffairs@oig.dhs.gov](mailto:DHS-OIG.OfficePublicAffairs@oig.dhs.gov)

### **What We Found**

Between 2011 and 2018, U.S. Customs and Border Protection (CBP) processed an average of \$896 million in drawback claims annually. However, a lack of internal controls could affect the validity and accuracy of the drawback claims amount. This occurred, in part, because CBP did not address internal control deficiencies in drawback claims. Specifically:

- CBP lacked appropriate documentation retention periods to ensure importers and claimants maintained support for drawback transactions;
- CBP's policies did not require drawback specialists to review an importer's prior drawback claims to determine whether, taken together, the importer claimed an excessive amount; and
- CBP's legacy drawback system lacked effective automated controls to prevent, or detect and correct, excessive drawback claims.

CBP plans to correct these deficiencies with the full implementation of the legislative and automated requirements under *Trade Facilitation and Trade Enforcement Act of 2015* that occurred on February 24, 2019. However, we are unable to determine whether the prior year audit findings have been resolved until sufficient data is generated to support compliance testing. As a result, we could not verify whether CBP remedied the identified internal control deficiencies and the related recommendations remain open.

### **CBP Response**

We included a copy of CBP's comments in their entirety in Appendix B.



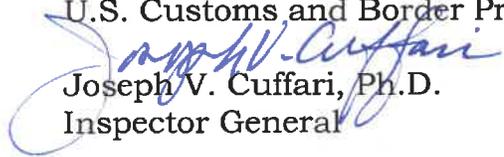
## OFFICE OF INSPECTOR GENERAL

Department of Homeland Security

Washington, DC 20528 / [www.oig.dhs.gov](http://www.oig.dhs.gov)

December 12, 2019

MEMORANDUM FOR: The Honorable Mark A. Morgan  
Acting Commissioner  
U.S. Customs and Border Protection

FROM:   
Joseph V. Cuffari, Ph.D.  
Inspector General

SUBJECT: *Lack of Internal Controls Could Affect the Validity of  
CBP's Drawback Claims*

For your action is our final report, *Lack of Internal Controls Could Affect the Validity of CBP's Drawback Claims*. This report contains no recommendations.

Consistent with our responsibility under the *Inspector General Act*, we will provide copies of our report to congressional committees with oversight and appropriation responsibility over the Department of Homeland Security. We will post the report on our website for public dissemination.

Please call me with any questions, or your staff may contact Sondra McCauley, Assistant Inspector General for Audits, at (202) 981-6000.



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### Background

U.S. Customs and Border Protection's (CBP) mission is to safeguard America's borders, thereby protecting the public from dangerous people and materials while enhancing the Nation's global economic competitiveness by enabling legitimate trade and travel. CBP is the second largest revenue collection agency for the Federal government, collecting more than \$47.3 billion in fiscal year 2018. This includes, by order of statute, issuing drawbacks. A drawback is a refund of any duties, taxes, and fees imposed on imported products later exported or destroyed. Figure 1 shows CBP personnel processing goods crossing U.S. borders.



**Figure 1. CBP Personnel Processing Imported Goods**

Source: <https://www.cbp.gov/newsroom/photo-gallery>

An importer or claimant must file a drawback entry, along with all documents necessary to complete the claim, generally within 3 years of exportation or destruction of merchandise. In accordance with Federal regulations,<sup>1</sup> CBP should verify the claim is complete and satisfies all drawback requirements. Additionally, CBP should verify the drawback amount and accounts for the refund, as well as pay the claim.

The *Trade Facilitation and Trade Enforcement Act of 2015* (TFTEA), Public Law 114-125, dated February 24, 2016, is the first comprehensive legislative change since 2003 affecting CBP's authorities when facilitating trade. TFTEA strengthens CBP's capabilities to enforce U.S. trade laws and regulations, streamlines and facilitates the movement of legitimate trade, and prevents noncompliant trade. TFTEA also changes the process that importers use to submit drawback claims. During the TFTEA implementation process from February 24, 2018, to February 23, 2019, importers filed drawbacks based on either the drawback law as it existed prior to TFTEA or under the new TFTEA rules.

<sup>1</sup> 19 Code of Federal Regulations (CFR) Part 191



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Further, TFTEA extended funding through 2018 for the Automated Commercial Environment (ACE) system. On February 24, 2018, CBP deployed the core trade processing capabilities in its ACE system, including electronic claims filing, built-in system validations, and improved system controls. ACE’s use eliminates more than 200 forms, which streamlines trade processes. ACE now serves as the primary automated system through which the trade community reports imports and exports. CBP also uses the system to determine import or export admissibility. ACE replaced the Automated Commercial System (ACS), which was CBP’s paper-based import process system importers used to file drawback claims prior to ACE’s implementation.

**Lack of Internal Controls Could Affect Validity and Accuracy of CBP’s Drawback Claims**

Between 2011 and 2018, CBP processed an average of \$896 million in drawback claims annually. However, lack of internal controls could affect the validity and accuracy of the drawback claims amount. Table 1 shows CBP’s total drawback refund claims from 2011 through 2018.

**Table 1: CBP Drawback Refund Claims, 2011–2018**

<b>January 1 – December 31</b>	<b>Claimed Amount</b>
2011	\$629,188,101
2012	688,996,404
2013	852,336,808
2014	908,784,032
2015	994,864,046
2016	1,003,188,545
2017	842,936,685
2018	1,250,507,327
<b>Total</b>	<b>\$7,170,801,948</b>
<b>Average Per Year</b>	<b>\$896,350,244</b>

Source: CBP-reported data and Office of Inspector General (OIG) analysis

CBP risked paying excessive drawback claims because it has not addressed reported control deficiencies in drawback claims. From FYs 2011 to 2018, Independent Auditors’ Reports on DHS’ Financial Statements and Internal Control over Financial Reporting (Appendix C) identified reoccurring CBP internal control deficiencies in drawback claims in three areas.



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#### **Inappropriate Documentation Retention Periods**

CBP's documentation retention periods were not appropriate to ensure that importers and claimants maintained support for drawback transactions for the full claim period and that CBP maintained support for importers qualifying for accelerated filer status. According to Federal regulations:

*During the period of retention, the broker must maintain the records referred to in this part in such a manner that they may readily be examined. Records required to be made or maintained under the provisions of this part must be made available upon reasonable notice for inspection, copying, reproduction or other official use by CBP regulatory auditors or special agents or other authorized CBP officers within the prescribed period of retention or within any longer period of time during which they remain in the possession of the broker.<sup>2</sup>*

Additionally, the Federal regulation<sup>3</sup> provides for a general 5-year document retention period. However, it also includes an exception clause, consistent with 19 United States Code § 1508(c)(3), which requires, "Any record relating to a drawback claim shall be kept until the third anniversary of the date of payment of the claim."<sup>4</sup> CBP has sought legislation to extend the period during which CBP can verify a drawback claim since the drawback claim lifecycle may extend beyond the 3-year retention period.

#### **Manual Review of Drawback Claims**

Manual drawback review policies did not require drawback specialists to review prior drawback claims from each importer to determine whether, taken together, the importer claimed an excessive amount. With TFTEA's implementation, importers may no longer submit manual claims. Until effective automated and manual controls are implemented to support review of the drawback process and identification of excessive claims, CBP may be subject to financial loss from importers claiming more than the amounts owed them. Even though TFTEA implementation has been completed, CBP should continue to enhance manual controls to prevent excessive drawback claims, as existing paper-based claims will take several years to process through the drawback cycle.

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<sup>2</sup> 19 CFR § 111.25

<sup>3</sup> 19 CFR § 163.4(a)

<sup>4</sup> 19 CFR § 163.4(b)



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#### **Lack of Controls to Detect Erroneous Drawback Claims**

The ACS drawback system lacked effective automated controls to prevent, or detect and correct, excessive drawback claims. Specifically, ACS could not link drawback claims to imports in sufficient detail. The system did not have the capability to compare, verify, and track essential information about drawback claims related to underlying consumption entries and export documentation. Consumption entries are a type of entry used when goods are imported for use in the United States and going directly into commerce without any time or use restrictions. Further, ACS did not restrict drawback claims to 99 percent of duties, taxes, and fees collected at the individual line item level and the entry summary level, in accordance with applicable regulations.

Until all claims were submitted under TFTEA requirements, CBP could not rely on the new system controls to prevent payment of erroneous claims. Instead, CBP relied on manual control processes to mitigate risks of inaccurate and fraudulent claims. Because CBP did not have sufficient resources to implement compensating manual controls effectively, the controls may not have been adequate to provide reasonable assurance to detect all excessive drawback claims. Lacking adequate controls, CBP may be subject to financial loss due to excessive drawback claims.

#### **CBP's Actions to Correct Internal Control Deficiencies Are Ongoing**

CBP concurred with the annual Financial Statement and Internal Control over Financial Reporting's findings and maintained that the new ACE system combined with policy updates will remedy the identified deficiencies. However, CBP's deployment of the ACE data processing system remains ongoing and at this time, we are unable to verify that these changes resolve prior year audit findings. Furthermore, CBP and the Trade Transformation Office have not yet finalized the *CBP and Trade Automated Interface Requirements* draft incorporating all TFTEA rules and regulations. We will conduct an audit once CBP finalizes policy updates and ACE's implementation generates sufficient data to support compliance testing.

We made no recommendations in this report as recommendations were reported in the Financial Statement and Internal Control over Financial Reporting audits. This report quantifies drawback revenue at risk because of reported internal control deficiencies.



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**Management Comments and OIG Analysis**

We have included a copy of CBP's comments in their entirety in Appendix B. CBP also provided technical comments to the draft report and we updated the report as appropriate. We recognize that, with the implementation of Automated Commercial Environment on February 24, 2019, CBP has completed the transition of drawback processing from paper-based filing and manual drawback claims to mandatory electronic submissions. However, we are unable to conduct an audit to determine whether prior year audit findings have been resolved until sufficient data is generated to support compliance testing.



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### **Appendix A**

#### **Objective, Scope, and Methodology**

The Department of Homeland Security, Office of Inspector General was established by the *Homeland Security Act of 2002* (Public Law 107–296) by amendment to the *Inspector General Act of 1978*.

We initiated this review to determine to what extent identified control deficiencies impact drawback claims. Our scope included FYs 2011 to 2018.

To answer our objective, we conducted a meeting with officials from CBP’s Office of Trade, Office of Financial Management, and Office of Chief Counsel in Washington, DC. During the meeting, we gained a better understanding of the drawback process currently in place and the implementation process for ACE drawback system, the primary automated system CBP uses to determine import and export admissibility. We obtained and reviewed the following drawback information:

- CBP’s drawback policies and procedures before and after the deployment of the ACE drawback system;
- laws and regulations prior to TFTEA’s passage;
- Notices of Findings and Recommendations from FYs 2011 through 2018 related to drawbacks; and
- annual drawback claims from 2011 through 2018.

We ensured there was sufficient basis to use work performed by the independent audit firm responsible for the Department of Homeland Security Independent Auditor’s Reports on Financial Statements and Internal Control over Financial Reporting. We obtained evidence of auditor qualifications and independence. We determined the scope, quality, and timing of the audit work was adequately reliable to answer our objective.

We analyzed the total claimed drawback amounts reported by CBP from 2011 through 2018. We did not attempt to verify the claims data, nor did we attempt to validate whether CBP had accurately categorized such data. However, we believe the funds at risk are appropriately quantified in this report. We assessed total claimed amounts from 2011 through 2018 to determine the average claimed amount per year.

We conducted this review under the authority of the *Inspector General Act of 1978*, as amended, and according to the *Quality Standards for Inspections and Evaluations* issued by the Council of the Inspectors General on Integrity and Efficiency.



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The Office of Audits major contributors to this report are William Johnson, Director; Kathy Hughes, Audit Manager; Kenneth Valrance, Auditor-in-Charge; Calbert Flowers, Auditor; Omar Russell, Auditor; Telogia Moore, Auditor; Thomas Hamlin, Communications Analyst; and Christopher Stephens, Independent Reference Reviewer.



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**Appendix B**  
**CBP Comments to the Draft Report**

1300 Pennsylvania Avenue NW  
Washington, DC 20229

SEP 30 2019



**U.S. Customs and  
Border Protection**

MEMORANDUM FOR: Joseph V. Cuffari, Ph.D.  
Inspector General

FROM: Henry A. Moak, Jr.  
Senior Component Accountable Official  
U.S. Customs and Border Protection

SUBJECT: Management Response to Draft Report: "Lack of Internal  
Controls Could Affect the Validity of CBP's Drawback Claims"  
(Project No. 18-051-AUD-CBP)

Thank you for the opportunity to review and comment on this draft report. U.S. Customs and Border Protection (CBP) appreciates the work of the Office of Inspector General (OIG) in planning and conducting its review and issuing this report.

CBP is pleased that the OIG recognized the complexity of the drawback program and the importance of ensuring accurate claims processing. The CBP Offices of Trade, Field Operations, and Finance collaborate to fulfill this critically important and complicated function.

Pursuant to Section 906 of the Trade Facilitation and Trade Enforcement Act of 2015 (TFTEA) (Pub. L. 114-125), CBP completed the transition of all drawback processing from the filing of paper and manual drawback claims to mandatory electronic submissions within the Automated Commercial Environment (ACE) on February 24, 2019. CBP updated internal and external policy guidance and engaged in proactive communications with the trade community to promote understanding of the drawback program modifications. CBP's automation and other implementation efforts significantly enhanced its ability to safeguard the revenue of the United States.

Processing drawback in ACE further institutionalized TFTEA provisions that prevent over-refunding of drawback claims. Several automated controls and legislative changes allow CBP to counter fiscal year 2011-2018 financial statement audit findings, while also streamlining drawback processing for both CBP and the trade community. These include:

- Mandatory line item reporting in ACE for TFTEA drawback claims;



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- Increasing the uniform drawback claim filing deadline from three years to five years from the date of importation; and
- Amending the recordkeeping date for the preservation of drawback claim supporting documentation from three years from the date of payment to three years from the date of liquidation.

CBP will continue to work to address questions and concerns regarding drawback and controls implemented in the new system (ACE); however, CBP is concerned that several statements in the draft report do not accurately reflect the current state of the drawback program. Specifically, the draft report states:

- “CBP plans to correct these deficiencies by implementing an updated data processing system and revising legislative procedures.” However, this does not reflect that full implementation of the legislative and automated requirements under TFTEA occurred on February 24, 2019. In addition, TFTEA claims are validated to the line level, confirming the unit of measure, merchandise value, quantity, and other line item details on the importation CBP Form 7501, “Entry Summary.” These validations ensure that dollars on the drawback claims are decremented at the line level. As directed by policy, drawback claims also remain subject to review requirements under selectivity criteria that subject claims to full-desk reviews by CBP personnel.
- “CBP has sought legislation to extend the period during which CBP can verify a drawback claim since the drawback claim lifecycle may extend beyond the 3-year retention period; however, a statutory change will require trade support and Congressional approval.” However, TFTEA effected this change by expanding the record retention period to three years from the drawback claim liquidation date (Title 19, Code of Federal Regulations (19 CFR) § 190.15).
- “Manual drawback review policies did not require drawback specialists to review prior drawback claims from each importer to determine whether, taken together, the importer claimed an excessive amount.” However, all first-time drawback claimants were, and still are, subject to a full claim review that includes an examination of the claim from importation, through manufacturing (as applicable), to export or destruction. Claimants that demonstrate the inability to file accurate claims or provide documentation as required are subject to additional scrutiny on every claim filed. Additionally, all pre-TFTEA drawback claims processed in the Automated Commercial System (ACS) were subject to additional screening at the time of filing, resulting in additional intensive claim examinations. CBP applied this screening at the drawback claimant level, ensuring all claimants were subject to random intensive reviews.



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While electronic filing of drawback claims is mandatory as of February 24, 2019, CBP acknowledges that pre-TFTEA drawback claims manually filed under the prior regulations (19 CFR § 191) will take time to process, due to the lifecycle of a drawback claim. It is important to note, however, that the dollar amounts of these claims were validated at the time of acceptance. In addition, CBP also reviews these claims based on the current policy for the ACS claim review process, which includes the random selectivity of claims for validation to ensure claims are accurate, and that overpayments are not issued. The selectivity includes criteria hits, first claims, and random hits.

The Chief Financial Officers Act of 1990 (CFO Act) (Pub. L. 101-576), requires that the Department of Homeland Security (DHS) undergo an independent annual consolidated financial statement audit, resulting in the issuance of an audit report to the Department. Prior year DHS Consolidated Financial Statement Audit Reports have identified a long-standing significant control deficiency related to drawback and custodial revenue. The current draft OIG report does not identify any new findings or recommendations in this regard.

CBP continues to aggressively work and liquidate pre-TFTEA drawback claims. Certain pre-TFTEA claim liquidations will be delayed until all designated imports are liquidated and final, and in the case of a pre-TFTEA NAFTA claims, subject to the “lesser of the two” rule, liquidation is delayed for a period of 3 years after the date of entry of the goods into Canada or Mexico.<sup>1</sup> In the meantime, CBP will provide DHS’ Risk Management and Assurance Division (RM&A), within the DHS Office of the Chief Financial Officer (OCFO), quarterly updates on the processing status of the pre-TFTEA drawback claims.

Again, thank you for the opportunity to review and comment on this draft report. CBP previously submitted technical comments under a separate cover. Please feel free to contact me if you have any questions.

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<sup>1</sup> Although the timeframe for liquidating these claims is beyond CBP’s control, CBP estimates these claims will be liquidated by FY2025, which will resolve the significant deficiency related to the drawback and custodial revenue audit findings reported in the DHS audit report.



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### Appendix C

#### **Prior DHS OIG Reports on Independent Auditors' Reports with Identified Control Deficiencies (2011–2018)**

*Independent Auditors' Report on DHS' FY 2011 Financial Statements and Internal Control over Financial Reporting*, OIG-12-07, November 2011, [https://www.oig.dhs.gov/sites/default/files/assets/Mgmt/OIG\\_12-07\\_Nov11.pdf](https://www.oig.dhs.gov/sites/default/files/assets/Mgmt/OIG_12-07_Nov11.pdf)

*Independent Auditors' Report on DHS' FY 2012 Financial Statements and Internal Control over Financial Reporting*, OIG-13-20, November 2012, [https://www.oig.dhs.gov/assets/Mgmt/2013/OIG\\_13-20\\_Nov12.pdf](https://www.oig.dhs.gov/assets/Mgmt/2013/OIG_13-20_Nov12.pdf)

*Independent Auditors' Report on DHS' FY 2013 Financial Statements and Internal Control over Financial Reporting*, OIG-14-18 Revised, December 2013, [https://www.oig.dhs.gov/assets/Mgmt/2014/OIG\\_14-18\\_Dec13.pdf](https://www.oig.dhs.gov/assets/Mgmt/2014/OIG_14-18_Dec13.pdf)

*Independent Auditors' Report on DHS' FY 2014 Financial Statements and Internal Control over Financial Reporting*, OIG-15-10, November 2014, [https://www.oig.dhs.gov/assets/Mgmt/2015/OIG\\_15-10\\_Nov14.pdf](https://www.oig.dhs.gov/assets/Mgmt/2015/OIG_15-10_Nov14.pdf)

*Independent Auditors' Report on DHS' FY 2015 Financial Statements and Internal Control over Financial Reporting*, OIG-16-06, November 2015, <https://www.oig.dhs.gov/assets/Mgmt/2016/OIG-16-06-Nov15.pdf>

*Independent Auditors' Report on DHS' FY 2016 Financial Statements and Internal Control over Financial Reporting*, OIG-17-12, November 2016, <https://www.oig.dhs.gov/sites/default/files/assets/2017/OIG-17-12-Nov16.pdf>

*Independent's Auditors' Report on DHS' FY 2017 Financial Statements and Internal Control over Financial Reporting*, OIG-18-16, November 2017, <https://www.oig.dhs.gov/sites/default/files/assets/2017-11/OIG-18-16-Nov17.pdf>

*Independent's Auditors' Report on DHS' FY 2018 Financial Statements and Internal Control over Financial Reporting*, OIG-19-04, November 2018, <https://www.oig.dhs.gov/sites/default/files/assets/2018-11/OIG-19-04-Nov18.pdf>



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