TRANSSHIPMENT
TECHNICAL INFORMATION FOR PRE-ASSESSMENT SURVEY (TIPS)

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PART 1 BACKGROUND

The purpose of this document is to provide guidance in performing a Pre-Assessment Survey (PAS) of the company's internal control to prevent unlawful transshipment and evaluating the results.

Generally Accepted Government Auditing Standards require the PAS team to obtain a sufficient understanding of internal control to plan the audit and determine the nature, timing, and extent of tests to be performed.

The guidelines and terms in this document are based on *Assessing Internal Controls in Performance Audits,* GAO/OP-4.1.4, published by the United States General Accounting Office, Office of Policy, September 1990; and American Institute of Certified Public Accountant's *Statement on Auditing Standards No. 78.*

PART 2 TRANSSHIPMENT GUIDANCE

Transshipment is the movement of goods through a second country en-route to the United States. Transshipment is legal and commonly used in the ordinary course of business. However, transshipment of merchandise for the purpose of circumventing trade laws and other trade restrictions applicable to the shipment is unlawful. For Customs purposes, unlawful transshipment involves claiming a false country of origin to circumvent quota, avoid paying higher duties (such as antidumping or countervailing duties), or to receive benefits from Special Trade Programs (e.g., NAFTA, Generalized System of Preferences (GSP)).

Unlawful transshipment can have the following effects:

- Decrease the competitiveness of the receiving country's domestic market;
- Create an unfair competitive edge for the violator;
- Establish an erroneous restraint level on a host country that was based on the level of unlawful transshipped goods; thereby, restricting the trade from legitimate manufacturers;
- Undermine bilateral textile agreements and other trade initiatives; and
- Confer fraudulent country of origin to the consumer.

Section 141.86(a)(10) of 19 CFR requires commercial invoices to include the country of origin for the merchandise. Section 12.130 of 19 CFR covers country of origin requirements for textile and textile products. Sections 10.173 and 10.176 of 19 CFR cover evidence of country of origin for merchandise claimed under GSP and merchandise produced in beneficiary developing countries respectively. See other trade area tech guides for additional country of origin criteria pertaining to those specific areas/programs.

The Federal Register, on a biannual basis (around March and September), issues a list of individuals and foreign entities located outside the Customs territory of the United States that have been issued a penalty claim under U.S.C. 1592 of the Tariff Act for certain violations of the Customs regulations. This list is referred to as the "List of Foreign Entities Violating Textile Transshipment and Country of Origin Rules" (19 U.S.C. 1592a list). The Federal Register is also available on the web at http://www.access.gpo.gov/su_docs/fedreg/frcont01.html.

A comparison of the manufacturers selected for the PAS sample to the Federal Register and the Bulletin Board should be performed to provide assurance that the company's internal control procedures are working.

2.1 EXAMPLES OF RED FLAGS

The following examples are conditions that may indicate a potential problem with transshipment.

- The company has insufficiently documented, poorly defined, or no internal control for prevention of transshipment of imported merchandise. Examples:
  - ✓ The company does not monitor or interact with the broker on transshipment issues.
  - ✓ The company relies on one employee to handle transshipment issues, and there are poor or no management checks or balances over this employee.
- The company or qualified agent representative does not visit the factory.
- The company does not exercise adequate control over their agents (buying/selling) regarding transshipment.
- The company's import staff lacks knowledge of transshipment issues such as U.S. Rules of Origin.
- Imported merchandise is subject to quota, antidumping duties, or other restrictions.
- Quota class merchandise is imported or admitted to a Foreign Trade Zone from an unlikely country of origin.
- The company makes quota/visa payments to a country other than the country declared to Customs and/or payments have been endorsed to other parties instead of factories.
- The purchase order does not identify the same manufacturer as the one identified in the commercial invoice.
- Freight bills do not identify the same countries of origin or export as the purchase order.
- Payments for the goods to the stated exporting or manufacturing factory could not be verified.
- ACS data showed the same Harmonized Tariff Schedule (HTS) number and manufacturer for entry type code "01" (consumption entry) and "03" (antidumping/countervailing duty (ADD/CVD)).
- ACS data showed a different country of origin and country of export for many of the company's imports and one or both of the countries may have trade restrictions.
- The company offers unreasonable explanations to Customs.
- The company fails to cooperate with or respond to Customs.
- The company has high turnover of people in key positions.
- A significant variance exists between the importer's data and Customs data.
- Customs shows a history of problems with transshipment issues (import specialist, account manager, compliance measurement, prior audit, other profile information).
- Company imports a high volume of merchandise under special duty provisions.
- The company uses factories that have been issued penalties for transshipment or that use many subcontractors.
- The company's import staff does not research the Customs Bulletin Board or the Federal Register for foreign entities violating textile transshipment and country of origin rules.
- Textile declaration is not signed or is missing original signature.

2.2 EXAMPLES OF BEST PRACTICES

- Internal controls for the prevention of transshipment:
  - ✓ Are in writing;
  - ✓ Include procedures for monitoring and feedback; and
  - ✓ Are monitored by management.

- One manager is responsible for control of the import department, including prevention of transshipment and accurate reporting of country of origin. That manager has knowledge of Customs matters and the authority to ensure that internal control procedures for imports are established and followed by all company departments.
- Written internal control procedures assign duties and tasks to a position rather than a person.
- The company has good interdepartmental communication about Customs matters.
- The company conducts and documents periodic reviews of entry summaries and makes corrections to entries and changes to their import operations as appropriate.
- The company requires periodic training for staff responsible for Customs matters.
- The company provides transshipment training to its agents and brokers.
- The company requests binding rulings from Customs on country of origin.
- The company agency agreements (buying and selling), purchase orders, employment contracts, or letters of credit contain clauses specifying transshipment certification requirements and penalty provisions.
- The company's inspection team makes regular unannounced visits to the plant to assure that a factory exists and that merchandise was produced at that factory.
- The company records and tracks visit to the factories along with the evaluation form.
- The company obtains profiles prepared by the factories, which state capacity levels, in order to determine whether proper ratio exists between the number of workers and the quantity produced.
- The company discontinues doing business with or puts factories on probation for failing the inspection and/or denying admission for an inspection by the company or its representative.
- The company provides a Quality Manual to its vendors stating its expectations of the vendor.
- The company's Quality Manual states that its vendors must obtain written approval from the company before making any changes regarding manufacturing facilities.
- The company has a plan of action or system to deal with factories that have been identified on the 19 U.S.C.1592a list.

2.3 EXAMPLES OF DOCUMENTS AND INFORMATION TO REVIEW

- Internal control policies and procedures.
- The company's response to the questionnaire.
- Interviews with company staff concerning actual procedures and controls specific to transshipment.
- Documentation that supports monitoring and verification of established and/or written internal control for prevention of transshipment.
- Process Map flowchart and narrative.
- Other documentation supporting country of origin and prevention of transshipment:
  - ✓ Receiving and inventory records.
  - ✓ Correspondence.
  - ✓ Factory inspection reports.
  - ✓ Factory profiles.
  - ✓ Quality control inspection sheets.
  - ✓ Sales confirmations, purchase contracts, or purchase orders.
  - ✓ Invoices and payment records (Letter of Credits, wire transfers).
  - ✓ Bills of lading/airway bills.

- ✓ Freight payment or accounting records.
- ✓ Buying/Selling agency agreements.
- ✓ Quota/Visa transfer forms.
- ✓ Quota/Visa payment records.
- ✓ Textile declarations.
- ✓ Quota/Visa charge statements.
- ✓ Binding rulings on country of origin.
- ✓ Antidumping Orders.
- ✓ Exporter's Certificate of Origin (ECO).

PART 3 RISK ASSESSMENT AND INTERNAL CONTROL GUIDANCE

PAS team judgement should be used to determine the type and amount of testing needed to evaluate how effective internal control is and whether there is risk to warrant proceeding to the Assessment Compliance Testing (ACT) phase.

Using the chart and the guidelines below, determine through limited judgmental testing whether the company's internal control is effective.

To determine the extensiveness of internal control testing, it is necessary to evaluate:

1. **Risk**; and

2. The **internal control** system, by determining whether the controls are in operation, how the controls were applied, how consistently they were applied, and who applied them.

3.1 RISK

A. Preliminary Assessment of Risk

Before any audit work begins at the company the team should make a preliminary assessment of risk (PAR) using information obtained from Customs or publicly available information. The purpose of the PAR is to evaluate identified potential risks to Customs based on analytical reviews of Customs data and other Customs information. This review will identify areas of potential risk and eliminate some areas with insignificant risk. The PAR should be conducted using the form in Attachment 1 to the PAS Audit Program.

Preliminary Assessment of Risk Examples

Example A: Low Risk Exposure

A query of ACS data and discussions with import specialists found no import activities from known transshippers or countries suspected of transshipping activity or merchandise subject to quota or antidumping. Since there were no PAS team concerns, the risk exposure level was considered low.

Example B: High Risk Exposure

A query of ACS data by vendors shows import activities from known transshippers. In addition, the profile showed a decrease in imports from Country A with quota restrictions and a corresponding increase from Country B with no quota restrictions. Due to the above concerns, the risk exposure level was considered high.

B. Evaluation of Risk Acceptability

After the audit work begins with the company the team will refine the assessment of risk. After all audit work has been completed the team will determine whether risk is acceptable or unacceptable using the PAS Audit Program as summarized in the following steps.

- Determine what activities pose a significant risk to Customs.

- Test the existence, effectiveness and implementation of internal control and determine if internal control is adequate to control risk.

- Using the results of the internal control review, develop an opinion whether risk is acceptable or unacceptable.

3.2 INTERNAL CONTROL

To evaluate the internal control system:

1. Consider the five components of internal control:

   - Control Environment.
   - Risk Assessment.
   - Control Activities.
   - Information and Communication.
   - Monitoring.

2. Review relevant Customs and company documents to identify and understand internal control for prevention of unlawful transshipment. (Examples of documents and information to review are listed on prior page.)

3. Determine whether the company has established and follows procedures. Review:

   - Documentary evidence of the results of periodic internal control reviews/testing and corrective action implemented.
   - Documentary evidence of communication with the broker and company departments on transshipment issues, including company testing of broker operations and verification that the broker followed company instructions.
   - Company-specific rulings requested. Determine if they are followed.
   - Documentary evidence of intra-company communications to ensure correct information is provided to Customs.
   - Training records and materials used to educate staff on Customs matters including transshipment issues.

4. Review written policies and procedures and interview applicable company personnel to complete appropriate sections of the Worksheet for Evaluating Internal Control (WEIC) for the Prevention of Unlawful Transshipment in PART 4 of this document.

   Note: The internal control assessment should include steps to:

- Identify and understand internal control.
- Determine what is already known about control effectiveness.
- Assess the adequacy of internal control design.
- Determine whether controls are implemented and effective.
- Determine whether transaction processes are documented.

3.3 EXTENSIVENESS OF AUDIT SAMPLE TESTS (TESTING LIMIT)

The purpose of limited PAS testing is to take a survey in order to determine the necessity for and extent of substantive tests. In some circumstances, the PAS team may decide that it probably will not be able to form an opinion based on limited PAS testing. In that case, it may be necessary to proceed immediately to the ACT process. If the PAS team believes that it can form an opinion based on limited PAS testing, test the appropriate number of controls and associated transactions using the table below.

Extensiveness of Audit Tests

PAR Level	+	Preliminary Review Internal Control	=	Extensiveness of Audit Test	Testing Limit
High		Weak Adequate Strong		High Moderate to High Low to Moderate	10-20
Moderate		Weak Adequate Strong		Moderate to High Moderate Low	5-15
Low		Weak Adequate Strong		Low to Moderate Low Very Low	1-10

Source: Adapted from *Assessing Internal Controls in Performance Audits.*
Column titled "Testing Limit" reflects Customs test sizes.

Example – Determine Testing Level

Based on a review of the profile and discussions with the import specialist, the team concluded that the risk exposure was low.

The company's internal control manual required factory visits prior to contracting with the factories. During factory visits, the company verified the data in the factory profile. The import manager provided documentation to support the fact that the Customs Bulletin Board and Federal Register are routinely reviewed for known overseas transshippers. Purchase orders and contracts were required to contain specific information to prevent and identify possible transshippers. After completing the Worksheet for Evaluating Internal Control, the team concluded the preliminary review indicated an adequate internal control system.

Using the table above (based on a low-risk exposure and adequate internal control system) the team concluded they would test 10 internal control transactions for the prevention of unlawful transshipment.

3.4 EVALUATION OF PRE-ASSESSMENT SURVEY TESTING RESULTS

The following steps are guidance for determining the effectiveness of company's internal control for the prevention of transshipment.

1. Complete the WEIC for the Prevention of Unlawful Transshipment to determine whether risk is acceptable or unacceptable and document why. Put results of testing in perspective and evaluate confirmed weakness as a whole. The evaluation should consider the results of the internal control testing, problems identified in the profile, and/or concerns raised by the import specialist or account manager. The team must evaluate the PAS results based on the specific situations.

2. The following will assist the PAS team in determining whether conditions warrant proceeding to ACT.

   Do not proceed to ACT if:
   - Cost-benefit analysis warrants no further effort, (do not spend a significant amount of resources to identify a potential loss of revenue considered insignificant.) and
   - The result of review indicated that the error was due to an isolated incident.
   - If substantive tests necessary to determine a compliance rate or revenue loss can be performed quickly and without extensive effort, the team should immediately perform the substantive tests without proceeding to ACT.

   Proceed to ACT if:
   - The company does not have an adequate internal control and the review indicated a material loss of revenue that cannot be quantified without statistical sampling or further review.
   - The importer will not quantify the loss of revenue.
   - The company refuses to take corrective action on systemic errors and it is necessary to calculate a compliance rate to evidence significant non-compliance.

   Note: If substantive tests necessary to determine a compliance rate or revenue loss can be quickly performed without extensive effort, the team should immediately perform the substantive tests without proceeding to ACT.

3. Determine whether referrals should be made for enforcement action.

3.5 EXAMPLES

The following examples of situations might be encountered during the PAS are for clarification purposes only:

Example A: Situation in which the team would not proceed to ACT (Revenue)

The auditor found that the importer has import activities from a company on the 19 U.S.C. 1592a list of known transshippers.

The PAS team reviewed the company's internal control procedures and found that the company has detailed written procedures to monitor factories and to prevent unlawful transshipment. The company also kept records of its visit to the factories and reviews its policy on transshipment with its buying agents. In addition, the import manager also documented the review of the 1592a list and Customs Bulletin Board for known transshippers. The company explained that there were only two purchases from the particular vendor and that the company stopped using the factory after it was found to be on the 1592a list. The PAS team verified that these were isolated incidents and that the importer was committed to following its written internal control procedures.

Example B: Situation in which the team would not proceed to ACT (Compliance)

Same as example A, except that the company did check the 1592a list on a regular basis and could show that they had stopped the two purchases mentioned above before they were shipped. During the PAS, the company established written procedures and implemented them.

Example C: Situation in which the team would proceed to ACT (Revenue)

The company does not have written internal control procedures to prevent unlawful transshipment. In reviewing documentation for transshipment, the PAS team found that the country listed on the manifest and bill of lading were from Vietnam and the country of origin declared on the Customs entry was China. The company spoke to the manufacturer and the Chinese manufacturer explained that it had contracted part of the production to its sister plant in Vietnam. Vietnam was subject to a higher duty rate (column 2) at the time.

The PAS team proceeds to ACT to quantify the loss of duty and to determine whether there were other incidents of transshipment. The PAS team also referred the case to the EET for review.

Example D: Situation in which the team would proceed to ACT (compliance)

Same situation as in C, except company refuses to take corrective action to prevent unlawful transshipment.

PART 4 WORKSHEET FOR EVALUATING INTERNAL CONTROL (WEIC) - TRANSSHIPMENT

PURPOSE: To determine whether Transshipment risk is acceptable.

The completion of this worksheet provides evidence that the five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communications, and Monitoring were evaluated.

During this phase of the process, an internal control review will be completed and factors for internal control related to an assessment of Risk Exposure including Internal Control Red Flags, Susceptibility, Management Support and Competent Personnel will be considered. The completion of this worksheet provides evidence that these factors were evaluated.

All answers must be linked to supporting documentation.

OBJECTIVES:

Section 1 - Internal Control Questions	Consolidate information learned about internal control through interviews and document reviews to form a preliminary assessment of internal control before testing. For work paper reference column titled "Is Implementation of Control Supported by Documentation and/or Interviews," confirm that the control is implemented through: • Interviews and requesting evidence from the company and • Reviews of documents that provide evidence that the company completed the activity.
Section 2 - Preliminary Internal Control Assessment	Use information consolidated in Section 1 to make a preliminary assessment whether internal control is strong, adequate, weak or nonexistent.
Section 3 - Sample sizes	Use the Preliminary Assessment of Risk (PAR) Level and the Preliminary Internal Control Assessment to determine the sample size for each sample.
Section 4 - Results of Sample Testing	Use information in Section 4 to record the results of PAS testing to evaluate whether internal control is effective to provide reasonable assurance of compliance.
Section 5 - Risk Opinion	Use information in section 1-4 to record the PAS opinion that risk is acceptable or unacceptable

Section 1 – Internal Control Questions

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
1.	Are internal controls for the prevention of unlawful transshipment formally documented?					
2.	Does management approve written policies and procedures?					
3.	Are written policies and procedures reviewed and updated periodically?					
4.	Is one manager responsible for control of the Import Department, including transshipment issues?					
5.	Does that manager have knowledge of Customs matters and the authority to ensure that internal control procedures for imports are established and followed by all company departments?					
6.	Do written internal control procedures assign transshipment duties and tasks to a position rather than a person?					
7.	Does company have good interdepartmental communication about transshipment matters?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
8.	Does company conduct and document periodic reviews of transshipment?					
9.	Do procedures require the company to constantly review the Federal Register web site to identify factories found to be transshipping or unable to produce production records?					
10.	Do procedures require the company to review the Federal Registers for violators of 1592a?					
11.	Do procedures require the Purchase Orders (PO) to identify the factory producing the garment, quantity, unit prices, and the specific garment style numbers so the commercial invoice with the Customs entry can be verified by any U.S. Customs Officer? POs should indicate if a factory is subcontracting out to another factory and the company must have the authority to approve the changes prior to production.					
12.	Do procedures require Letters of Credit to state the beneficiary manufacturer, state that textile transshipment is prohibited and include penalty provisions in the event transshipment occur?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
13.	Do procedures require suppliers to undergo a thorough approval process prior to the first importation? Documentation should indicate that approval was granted to contract with new factories before importation. Documentation may include a check list or standard approval form indicating quality, quantities, machinery & equipment, and production lead times.					
14.	Do procedures require the company to obtain and analyze Factory Profiles to determine whether the factory can produce the desired quantities? Profiles should be validated during the company's on-site visits.					
15.	Do procedures require factory visits to be unannounced and conducted by different company staff or agents?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
16.	Do procedures require the factory visits to be fully documented? Documentation should include: 1) an observation of all phases of the production process from the receipt of raw materials to the work-in-process of the sewing and cutting operation to the finished goods and sale; and, 2) a comparison of the number of sewers to number of machines in relation to production and the number of sewers to number of packers. The visits and documentation should identify specific styles and all processes must relate back to the purchase order.					
17.	If an import is detained at a port and productions records requested, do procedures require the company to do a complete review of the internal control process that was in place to select this manufacturer?					
18.	If weakness were found during internal control testing, were corrective actions implemented?					
19.	Is one department/individual primarily responsible for the prevention of transshipment and meeting country of origin requirements?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
20.	Does the individual responsible for prevention of transshipment, country of origin have adequate knowledge and training?					
21.	Is Customs assistance sought regarding transshipment or quota (e.g., requesting binding rulings)?					
22.	Do procedures require periodic monitoring of overseas factory's production and review of factory capacities in relation to the company's imports?					
23.	Do procedures include monitoring specific quota closures for specific commodities from certain factories with a past history of transshipping?					
24.	Do procedures require periodic reviews of changes in freight companies used by overseas suppliers?					
25.	Do procedures require periodic review for new manufacturers that appear after country closures of specific categories?					
26.	Do procedures require the importer to evaluate overseas agent activities? Are evaluations documented and updated periodically?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
27.	Do procedures require overseas agents to receive training or demonstrate knowledge regarding transshipment issues?					
28.	Do procedures require suppliers to maintain ISO 9000 certification?					
29.	Do procedures require verification that the foreign company/person completing required documentation (textile declarations, Certifications of Origin) is knowledgeable about Customs requirements?					
30.	Do procedures require review of Outward Processing Agreements (OPA)? OPA is a document which states factories in more than one country are involved in the manufacturing process or subcontract to other factories in other countries than their own.					
31	Do procedures require that commercial invoices contain the same specific and adequate garment styling description as listed on the PO?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
32.	Do procedures require the Cut, Make, and Trim operations to be visited and approved? (Applies to importers whose major programs consist of buying fabrics and sending the fabric for a Cut, Make & Trim operation.)					
33.	Do procedures require that payment be made only to quota holders or manufacturers who are listed as obtaining the quota?					
34.	Do procedures require periodic review of the quota allocations of the factory?					
35.	Does the company have adequate broker oversight?					
38.	Does the company have adequate internal control to address specific issues identified in the profile?					
39.	Does the company identify analyze and manager risks related to transshipment?					
40.	Has the company identified any risks related to transshipment and implemented control mechanisms?					
41.	List company-specific procedures and controls below (if applicable)					

Section 2 - Preliminary Internal Control Assessment

Use information obtained in section 1 above to make a preliminary assessment of internal control as strong, adequate, weak, or nonexistent.

	Strong	Adequate	Weak	None*
Internal Control				

***** If the team concludes that the company does not have internal control, risk is not acceptable so proceed to Section 5 below.

Section 3 – Sample Sizes

Use the matrix for determining Extensiveness of Audit Tests in section 3.3 of TIPS to determine the extensiveness of audit tests to confirm that internal control is effective. Multiple samples are possible. Samples and sample items should concentrate on risk.

Sample Area	PAR Level (High, Moderate, or Low)	Internal Control Level (Weak, Adequate, or Strong) From Section 2 Above	Testing Limit (1-20)

Section 4 - Results of Sample Testing

Use the results of sample testing to determine if internal control is effective.

Results of Testing	Yes or No
Is IC effective to provide reasonable assurance to preclude significant risk?	

Section 5 - Risk Opinion

Use the information developed in Sections 1-4 to record the PAS opinion that risk is acceptable or unacceptable.

Risk Opinion	Yes or No	Comments
Acceptable		

If risk is not acceptable the audit team may need to proceed to ACT or have company do quantification.