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United States General Accounting Office

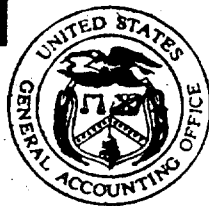
Report to the Chairman, Subcommittee
on Oversight, Committee on Ways and
Means

July 1990

CUSTOMS AUTOMATION

Duties and Other Collections Vulnerable to Fraud and Abuse

A280 826



94-19994





United States
General Accounting Office
Washington, D.C. 20548

Information Management and
Technology Division

B-231311

February 28, 1990

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

Dear Mr. Chairman:

This report responds to your May 17, 1989, letter, in which you requested that we examine certain controls relating to the U.S. Customs Service's automated revenue collection and deposit processes. Your request was triggered, in part, by our disclosure of internal control weaknesses in these processes during hearings before your Subcommittee on April 17, 1989.¹ During those hearings and in an earlier report,² we indicated that inadequate controls over the automated tracking of pre-numbered collection documents and untimely reconciliation of collections to bank deposits may have contributed to \$4.2 million in thefts that remained undetected for lengthy periods of time—in one case for nearly a year and in another for more than 2 months. Accordingly, you requested that we conduct a comprehensive review of these two areas.

As agreed with your office, we initiated a review of Customs' internal controls related to the use of pre-numbered collection documents and the processes used for reconciling collections to bank deposits. Although our review is still underway, several important and disturbing facts have come to our attention regarding Customs' use of pre-numbered collection documents at ports of entry. For this reason we are providing you with the results of our work in this area earlier than previously planned so corrective actions can be taken as soon as possible. Our work relating to reconciliation of collections to bank deposits is continuing, and we will report on that work at a later date.

At 300 ports of entry (including airports, seaports, and land border crossings), over 8,000 Customs inspectors, tellers, and other employees collect duties on imports and goods brought into the country. These employees also collect taxes, fees, fines, and penalties. Often the duty and other collections are paid in cash or with a check and recorded using

Accession For	
NTIS CRA&I	☒
DTIC TAB	☐
Unannounced	☐
Justification	
By	
Distribution /	
Availability Codes	
Dist	Avail and/or Special
A-1	

¹Internal Control Weaknesses in Customs Revenue Collection Process (GAO/T-IMTEC-89-5, April 17, 1989).

²Customs Automation: Internal Control Weaknesses in Customs' Revenue Collection Process (GAO/IMTEC-89-50, April 11, 1989).

pre-numbered collection documents. These documents serve as a receipt to the payer and a source for entering the transaction into Customs' automated information system known as the Automated Commercial System (ACS). Customs does not maintain records on how much of its collections are made using pre-numbered collection documents. At our request, Customs analyzed its computer records of fiscal year 1989 collections and estimated that between \$600 and \$700 million was collected using about 630,000 such documents.

Because cash collections (including checks) offer the potential for theft, fraud, and abuse, they must be carefully controlled. The basic control that Customs uses for cash collected by its employees is the pre-numbered collection document. Pre-numbering these documents facilitates their control and each one is supposed to be accounted for in ACS. Documents that cannot be located or otherwise accounted for could represent lost or stolen collections.

Results in Brief

Customs could be losing millions of dollars in duties and other collections due to fraud and abuse because of an almost total breakdown of internal controls over its pre-numbered collection documents. Although the total is unknown, Customs estimates that several million collection documents could not be accounted for following nationwide inventories conducted in fiscal years 1987 and 1988.

In addition, over the last 5 years, Customs' National Finance Center (NFC) changed the status of nearly 5 million documents from "unused" to "used" in ACS. According to NFC officials, these changes were made because they feared an astronomical growth in the number of unaccounted for documents when the next inventory was taken. In 98 percent of these cases, however, there were no collections recorded in ACS. One obvious implication of an "unaccounted for" document is that money could have been collected and subsequently lost or stolen along with the document. By changing the status of these documents to "used," Customs exacerbates the problem because many of them may still be in the possession of Customs employees but will no longer be tracked in ACS and are no longer considered a problem. This breakdown in internal controls could present a significant opportunity to misuse them without fear of detection. Also disturbing is that the Deputy Commissioner and Comptroller of Customs told us they were unaware that nearly 5 million unaccounted for documents had been changed to a used status.

Several other internal control weaknesses at ports of entry have led to this breakdown in accountability over these documents. We visited three major ports accounting for about 12 percent of Customs' total revenue in fiscal year 1989 and found poorly executed controls over the assignment of documents to Customs employees. For convenience, documents were assigned to groups of employees instead of to individual employees as required by Customs' procedures. In addition, even though prudent management and Customs' own policies call for timely investigation of unaccounted for documents, these investigations were done on a part-time, low priority basis. As a result, at the three ports we visited, about 67 percent of their unaccounted for documents as of December 1989 had been in this status for over 6 months.

Under the Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512 (1982)), agencies must establish internal controls to ensure that their missions and related activities are effectively carried out and to annually report weaknesses in these controls and the status of corrective actions taken. We believe the weaknesses in Customs' internal controls over its collections using pre-numbered collection documents are sufficiently serious to warrant disclosure and corrective actions under the act's provisions.

It is possible that modern technology could be used in place of current pre-numbered collection documents to help control collections. For example, the ACS system has the capability to electronically "capture" collection information from cash registers at ports thus negating the need to manually record collection transactions on pre-numbered collection documents. In addition, hand-held devices are available on the market to automate the revenue collection process in locations where there are no cash registers.

Appendix I contains background information on the matters discussed in this report and details of our findings. Our objective, scope, and methodology are shown in appendix II.

Conclusions

The lack of internal controls over pre-numbered collection documents and the staggering number of unaccounted for documents provide an enormous potential for abuse and cover-up. Widespread thefts and other fraud and abuse may be occurring. Accordingly, such weaknesses materially affect Customs' ability to carry out its mission and therefore should be reported under the Federal Managers' Financial Integrity Act.

Given the almost complete breakdown in internal controls over pre-numbered collection documents and the large thefts that have already occurred, prompt and vigorous action is needed.

Modern technology could make the use of pre-numbered collection documents obsolete. But technology alone cannot solve the problems we found with Customs' control over collections. A careful assessment of all controls is and will be needed, even with new technology, to assure that each collection is accounted for properly.

Recommendations

We recommend that, in the short term, the Commissioner of Customs:

- Discontinue immediately the use of the current pre-numbered collection documents and convert to a new pre-numbered format that would clearly be a recognizable change in document design and/or color scheme. Brokers, importers, and others likely to do business with Customs should be notified not to accept as a receipt for payment a collection document other than one in the new format.
- Enforce stringent internal controls over the assignment and use of the new pre-numbered documents. At a minimum, internal controls should be instituted so that documents can always be traced to the individual to whom assigned, all changes in the status of documents are properly justified, and error reports on missing documents are promptly resolved.
- Report the lack of internal controls over pre-numbered collection documents as a material weakness under the Federal Managers' Financial Integrity Act, and report the status of corrective actions taken.

For the longer term, we recommend that the Commissioner direct that an analysis be made of the collection process with a view towards the possible use of modern information technology to eliminate the use of such documents, when feasible. The analysis should include a thorough risk assessment to determine the vulnerabilities of any such technology and the establishment of appropriate internal controls to mitigate the vulnerabilities.

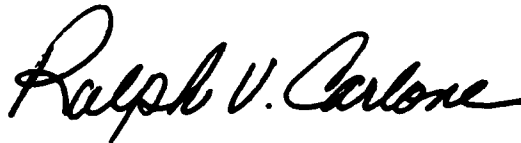
As requested by your Office, we did not obtain formal comments from Customs on a draft of this report. We did, however, discuss its contents with the Deputy Commissioner and Comptroller of Customs. These officials agreed that Customs faces serious internal control problems in its use of pre-numbered collection documents and stated that they were

unaware that nearly 5 million documents were converted to a used status without corresponding collections recorded in ACS. They also agreed with our recommendations, and stated that they would act upon them. The Deputy Commissioner also said that Customs would seek to establish additional improvements in its internal controls over these documents.

As agreed with your office, unless you publicly announce this report's contents earlier, we plan no further distribution until 30 days after the date of its issuance. At that time we will send copies of this report to the Chairmen, House and Senate Committees on Appropriations; Chairman, House Committee on Government Operations; Chairman, Senate Committee on Governmental Affairs; and the Director, Office of Management and Budget. We will also send copies to the Secretary of the Treasury, the Commissioner of Customs and other interested parties.

This report was prepared under the direction of Howard G. Rhile, Director, General Government Information Systems, who can be reached at (202) 275-3455. Other major contributors are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink that reads "Ralph V. Carlone". The signature is written in a cursive, flowing style.

Ralph V. Carlone
Assistant Comptroller General

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Abbreviations

ACE	Automated Commercial System
GAO	General Accounting Office
IMTEC	Information Management and Technology Division
NFC	National Finance Center

Background and Details of Our Findings

Customs has been developing and implementing its ACS since 1984. This system is aimed at integrating all of Customs' commercial operations to aid Customs in inspecting merchandise imported into this country and collecting related duties, taxes, fees, fines, and penalties.

In fiscal year 1989, Customs collected nearly \$19.1 billion in duties, fees, fines, and other charges. Most of this represents duties on large imports. Each large import enters the United States through a process known as a formal entry. In this process, most brokers and large importers electronically transmit information to ACS on the type and quantity of merchandise being imported, along with an estimate of the associated duties, taxes and fees. These transmissions are made in advance of the cargo's arrival. Generally, payments must be received by Customs within 10 days after the imported merchandise has been released into the commerce of the United States.

A portion of the \$19.1 billion was collected from importers and the general public and consists of taxes, fees, fines, penalties, and duties on small imports and on goods brought into the country by airline and ship passengers.¹ In contrast to the formal entry process, these amounts are not always entered into ACS prior to payment and are usually in the form of small checks and currency. Often these collections are recorded first on pre-numbered collection documents² by Customs' inspectors, tellers, and other employees before being entered into ACS. Customs' records indicate that approximately 630,000 pre-numbered collection documents were used in fiscal year 1989. However, Customs does not maintain records on how much of its collections are made using these documents. At our request, Customs analyzed its computer records of collections made with pre-numbered collection documents. Between \$600 and \$700 million of the \$19.1 billion collected in fiscal year 1989 was collected using such documents.

Document numbers are entered into ACS with the amount collected so documents missing from the sequence can be (1) identified on monthly error lists, (2) researched to determine the cause for the discrepancy,

¹Passengers and importers receive a cash register receipt at those ports that have registers. When a register is used, pre-numbered collection documents are used to summarize the amounts collected during a work shift.

²Customs uses two documents for this purpose. The most frequently used is the Cash Receipt (CF-5104) which is used primarily for recording taxes, fees, passenger duties and any collection where there is no other designated form for the particular type of collection involved. The other document is called an Informal Entry Form (CF-5119-A). This is used to record collections of duties and other amounts due from importers and brokers on imports valued at \$1,250 or less.

and (3) removed from the error list after the discrepancy has been resolved.

Customs has had problems using and controlling pre-numbered collection documents. For example, in our report and testimony in April 1989 on Customs revenue controls, we cited a major fraud at a Customs port involving repeated thefts of collections over almost a 1-year period totaling nearly \$840,000. The thefts, which occurred at the Los Angeles International Airport, were accomplished by a former Customs' supervisory aide who failed to deposit funds received, and either falsified or destroyed pre-numbered collection documents to cover up the thefts. A Customs Internal Affairs investigation concluded that several internal control weaknesses, including failure to resolve discrepancies shown on error reports of missing collection documents, created an environment which contributed to the thefts not being detected by Customs.³ In this case, the fraud was detected only after a passenger complained to Customs about not receiving a canceled check. The subsequent investigation by Customs Internal Affairs disclosed the magnitude of the fraud. The employee has since been convicted and sentenced and procedures at Los Angeles have been changed to prevent the reoccurrence of a similar scheme.

The following sections in this report discuss three major internal control breakdowns in Customs' use of pre-numbered collection documents. Millions of documents were unaccounted for and their status improperly changed as a result of Customs' nationwide inventories conducted in 1987 and 1988. Also, at the three major ports we visited—JFK airport, New York; New Orleans seaport, Louisiana; and San Ysidro land border crossing, California—we found poorly executed controls over the assignment of collection documents to Customs' employees and low priority given to resolving unaccounted for documents. These three ports accounted for about 12 percent of Customs' total collections in fiscal year 1989.

³During the past several years, Customs' Office of Internal Affairs has produced numerous reports that criticized weaknesses in the controls over pre-numbered collection documents and noted that such weaknesses contributed to thefts and losses of revenue.

Millions of Pre-Numbered Collection Documents Unaccounted for and Status Improperly Changed

A basic tenet of good accounting controls over the handling of cash collections is the use and proper control of pre-numbered collection documents. However, we found a significant breakdown of this basic internal control. According to Customs, millions of unused pre-numbered documents could not be accounted for following annual inventories in fiscal years 1987 and 1988. In addition, over the last 5 years, Customs changed approximately 4.8 million documents to a used status without evidence in ACS that any funds were actually collected. Customs made these changes to avoid increases in the number of unaccounted for documents. Although we have not determined if the abuse of pre-numbered documents has resulted in widespread fraud, the lack of effective controls and the fact of previous thefts signal its potential.

Millions of Documents Unaccounted for

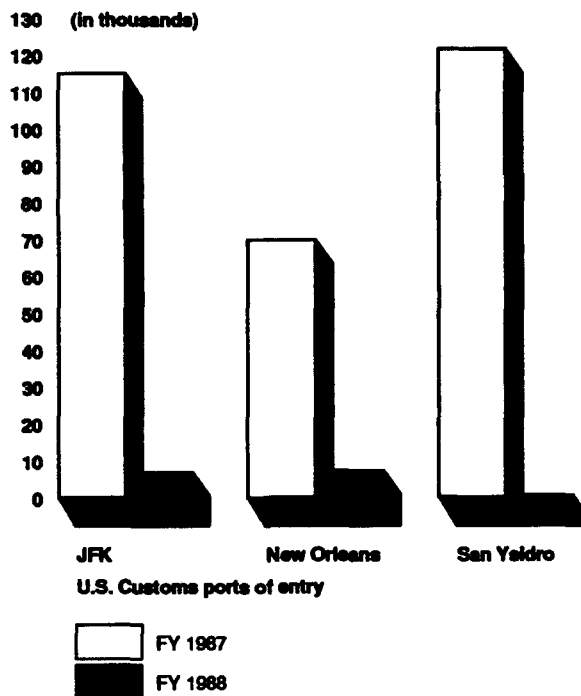
In fiscal years 1987 and 1988, Customs' NFC conducted nationwide inventories of its pre-numbered collection documents on a district-by-district basis.⁴ Each district was requested to conduct an inventory and forward the serial numbers of all documents in its inventory to NFC. NFC entered the serial numbers into ACS for comparison with ACS files containing each document's assigned location and status. From this comparison, discrepancy reports were generated that listed (1) unused documents that were assigned to a port but not in the port's reported inventory, (2) documents that were not assigned to a port but were in the port's reported inventory, and (3) documents that were assigned to one port but reported as used by another. From this initial comparison, millions of documents had to be researched and reconciled.

The inventories conducted in 1987 and 1988 disclosed that Customs could neither locate nor otherwise account for a sizeable number of documents. ACS does not retain past inventory results, and the hard-copy inventory reports were at each of Customs' nearly 300 ports of entry in a format which neither Customs nor GAO could readily summarize. Accordingly, we did not obtain the number of unaccounted for documents nationwide or on a port-by-port basis. However, NFC officials and staff researching the inventories said the number nationwide was in the millions.

⁴A nationwide inventory on a region-by-region basis was attempted in the early 1980s before the establishment of NFC. The inventory was never completed due to what was described by Customs officials as "coordination problems" between Customs' Headquarters and the seven Customs regions in forwarding and receiving information on document discrepancies. The results of the 1989 inventory were not available at the time of our review.

Our review of hard-copy inventory records for the 3 ports we visited showed unaccounted for documents totaling 306,604 and 14,799 for fiscal years 1987 and 1988. A large number of unaccounted for documents suggests that money could have been collected and later lost or stolen along with the associated collection documents. As shown in Figure 1 below, the number of unaccounted for documents declined significantly in fiscal year 1988. But, as discussed in the next section, this decline was mainly attributable to unsubstantiated changes or adjustments made by NFC.

Figure I.1: Unaccounted for Collection Documents, Fiscal Years 1987 and 1988



Status of Unaccounted for Collection Documents Improperly Changed to Appear as If Properly Used or Canceled

To determine how the status of those documents identified as unaccounted for on inventory discrepancy reports was resolved, we randomly selected a sample of 50 documents for each port from the fiscal years 1987 and 1988 inventory discrepancy reports—a total of 300 documents. For each document, we researched computerized ACS files and NFC hard-copy files. Our purpose was to determine how the discrepancies were resolved and the basis for any revisions. We found, as shown in Table 1, that 72 percent of these documents were changed to a used status or canceled as of September 1989.

Table 1: Resolution of Unaccounted for Collection Documents Sampled in Fiscal Years 1987 and 1988 Inventories

Resolution	JFK	New Orleans	San Ysidro	Total	
				Number	Percent
Unused	25	20	0	45	15
Used	5	31	2	38	13
Changed to used	42	49	97	188	62
Canceled	28	0	1	29	10
	100	100	100	300	100

The 38 documents listed as used appear to have been used properly. However, of the 188 documents changed to a used status, we found no supporting collection data in the computerized ACS records or in the hard-copy files at NFC. In addition, of the 29 canceled documents, 27 or 93 percent did not have supporting documentation—copies of the canceled documents in the NFC files—to show that they were properly accounted for.

Because of the significant number of pre-numbered collection documents in our sample that were either changed or canceled without supporting documentation, we queried the ACS system to determine how many documents throughout all of Customs had been changed to used or canceled during the past 5 years. We also determined how many of those that were changed to used had corresponding collection data recorded in ACS. We found 8.3 million documents identified by ACS as having been either used or canceled for the period October 1984 to September 1989. Of these, 4.8 million (57 percent) had been changed to a used status; only 83,000 or about 2 percent of the 4.8 million had collections recorded in ACS.

NFC officials, who were responsible for making the above changes, said that the changes were made to lower the overall number of unaccounted for documents. They explained that the massive number of unaccounted

for documents, coupled with the failure on the part of ports and districts to locate them during the annual inventories, would otherwise result in an astronomical increase. NFC staff acknowledged that no collection data were available to support most of the changes, but that many changes were requested in memorandums from Customs districts. These memorandums indicated that the documents or copies of them were no longer available at the ports and directed that such changes be made. The Chief, NFC Revenue Branch, explained that in fiscal year 1987, NFC began requesting the districts to prepare such memorandums as a basis for making the changes.

Without evidence in the form of collections recorded in ACS or in the hard-copy NFC files that collections were actually made, many documents changed to a used status or canceled may still be in the possession of Customs employees. The documents will also no longer appear on inventory discrepancy reports. In addition, if an attempt is made to enter into ACS a document previously changed to used, the system will alert the user that the document was already recorded as used, thus offering an additional opportunity for abuse. This breakdown in internal controls provides an unparalleled opportunity to misuse these documents without detection.

Other Internal Control Weaknesses Over Pre-Numbered Collection Documents Led to Unaccounted for Documents

The high number of missing or unaccounted for pre-numbered collection documents was the result of other major breakdowns in Customs' internal controls. These include (1) poorly executed controls over the assignment of unused pre-numbered collection documents to Customs employees, and (2) the low priority given to resolving unaccounted for documents at ports.

Procedures Not Followed for Assigning Documents

The NFC is responsible for distributing pre-numbered collection documents to districts and ports. Accountability and use of these documents are tracked through ACS. Customs' Policies and Procedures Manual, 5311.9B, dated December 3, 1984, requires that each district and port designate a forms issuance officer responsible for issuing pre-numbered collection documents, maintaining a log of the documents issued for use, and receiving and reviewing record copies of used documents. The manual states that the log should include the numbers of the documents issued and the signature of the employee to whom issued. To assure

accountability for the documents and money collected using them, the manual also states that the documents are to be under the personal control of an employee and shall not be issued to a dock or desk, such as a passenger processing desk. Also, the documents are not to be loaned or transferred between employees without authorization.

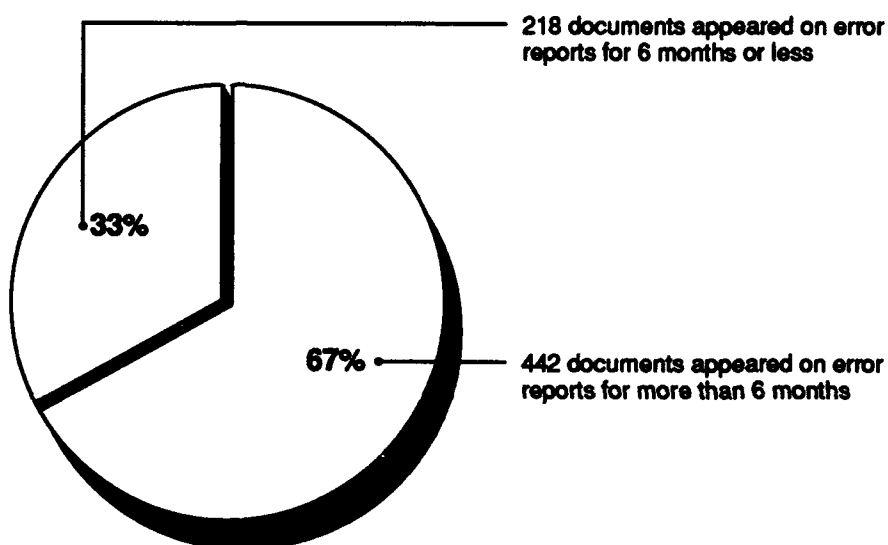
Customs is not following these procedures. At two of the ports we visited, books of pre-numbered collection documents were not being issued to individuals as required by Customs' policies. At the San Ysidro land border crossing, books of collection documents were being issued to the passenger processing desk where several inspectors used the same book. At the New Orleans Customshouse, books of the documents were being issued to a division. In both instances, port officials said this was done for convenience and to reduce the manual record-keeping resulting from assigning documents to individuals. We also found the three ports we visited were not using ACS to track the assignment of documents to individuals, although ACS was designed to perform this function. Instead, NFC used the system to record the assignment of documents only at the district or port level. Port officials said that, because ACS is limited to tracking document assignments to individuals using only a 5-digit number, they did not use this system feature. They suggested redesigning the system to use nine digits to track document assignments through employees' Social Security numbers. Customs plans to modify the ACS system to accept a nine-digit employee identification number by June 1990.

Low Priority Given to Resolving Monthly Error Reports

According to Customs' policies and procedures, district and port directors are responsible for reviewing ACS error reports identifying unaccounted for collection documents. These monthly reports identify missing documents and documents used out of sequence. Section 5311.9D of Customs' Policies and Procedures Manual states that these "reports are to be verified on a timely basis by an assigned responsible employee...." However, at the ports we visited, personnel assigned to investigate error reports said they had other duties and did not consider the error reports a high priority. At the San Ysidro port the responsibility for investigating error reports was assigned to a cashier; however, the cashier was not able to work on the report because of other workload responsibilities. At the two other ports visited, we were told that work on the report is done only on a part-time basis. Because of the low priority accorded this task, documents remained unaccounted for over

long periods of time. As indicated in Figure 2, most of the 660 documents on the December 1989 error reports for these ports were unaccounted for longer than 6 months.

Figure I.2: Percentage of Collection Documents Appearing on December 1989 Error Reports Less Than/More Than 6 Months



Selected Customs ports of entry: JFK, New Orleans, and San Ysidro

Control Weaknesses Need to Be Disclosed Under the Federal Managers' Financial Integrity Act

The internal control weaknesses identified during our review—a preponderance of unaccounted for collection documents coupled with the improper change of millions of these to a “used” status, the failure to follow required procedures in assigning documents, and the low priority given to resolving monthly error reports—impair Customs’ effectiveness in collecting taxes, fines, penalties, and duties on small imports and goods brought into the country by airline and other passengers. These are the kinds of problems that require review, disclosure, and corrective actions under the provisions of the Federal Managers’ Financial Integrity Act. Agencies must establish a system of internal controls to ensure that their mission and related activities are carried out. This includes annually reviewing their internal controls and reporting any weaknesses identified in these controls along with the status of corrective actions. Customs did not disclose these weaknesses in its annual report for fiscal year 1989.

Customs Does Not Use Available Technology to Control Cash Receipts

In developing ACS beginning in 1984, Customs continued the use of pre-numbered documents to control collections, although other processes—such as selecting cargo for inspection and releasing inspected cargo—were being automated. According to Customs, the automation of these processes was its highest priority. As a result, ACS does not use modern technology to control collections. For example, the cash registers used at ports to collect revenues can electronically transmit collection information directly to ACS, thus eliminating pre-numbered documents and the opportunity to use them fraudulently at these locations. Instead, the cash registers are used to maintain a register tape of daily transactions. This tape is used as the basis to manually prepare a pre-numbered collection document which, in turn, is used to manually enter the amounts collected into ACS.

Modern technology can also be used instead of these documents where collections are made by an inspector who is far from a cash register. For example, at least three companies manufacture hand-held devices that can be used to automate the revenue collection process. These devices, which are used in various business and government applications such as billing and collecting automobile rental fees and inventory control, can electronically produce a cash receipt; and could store the collections data and transmit the collection information directly to ACS. Their use could therefore eliminate the need for processing pre-numbered collection documents, which is both labor-intensive and difficult to control.

Objective, Scope, and Methodology

Our objective was to assess the controls over Customs' use of pre-numbered collection documents at three ports of entry. Customs' field structure consists of 7 regions, 44 districts, and approximately 300 ports. We visited ports in three geographically diverse regions: New Orleans, Louisiana; San Ysidro/Otay Mesa¹, California; and JFK International Airport, New York. These ports include a seaport, land border crossings, and an airport; they accounted for \$2.3 billion or 12 percent of Customs' \$19.1 billion in revenue for fiscal year 1989.

At each port, we conducted a data flow analysis. The purpose of the data flow analysis was to document the use of and assess the internal controls over pre-numbered collection documents at each point in the revenue collection process. We also obtained and analyzed Customs' monthly error reports dated December 31, 1989, to determine the age of the discrepancies shown on the reports. These reports show missing documents and those used out of sequence. We also sampled, for the three ports visited, 300 documents listed as discrepancies on Customs' fiscal years 1987 and 1988 inventory discrepancy reports. We followed up at each port and the National Finance Center to assess Customs' efforts to account for documents identified in these reports. In addition, we obtained a copy of an ACS automated file listing the status of pre-numbered documents. For documents that were adjusted to a used status from October 1984 to September 1989, we asked Customs to provide us with ACS collection data to determine the number having revenue collections associated with them.

To determine Customs' policies, practices, and procedures regarding the use and tracking of pre-numbered collection documents, we interviewed officials at Customs headquarters in Washington, D.C. and the National Finance Center in Indianapolis, Indiana; and reviewed documentation furnished by them. We also interviewed Customs employees involved in the distribution, maintenance, storage, and use of these documents at the three ports visited. Our work was performed in accordance with generally accepted government auditing standards, from May 1989 to January 1990.

¹ Although San Ysidro and Otay Mesa are separate border crossings, they are classified as a single port by Customs for accounting purposes.

Major Contributors to This Report

**Information
Management and
Technology Division,
Washington, D.C.**

Thomas E. Melloy, Assistant Director
David B. Alston, Evaluator-in-Charge
Joyce A. Keyes, Evaluator

**Cincinnati Regional
Office**

Roberto Rivera, Evaluator
Katrina Stewart, Evaluator

**Los Angeles Regional
Office**

James D. Moses, Evaluator
Susan Abdalla, Evaluator

**New York Regional
Office**

Anthony R. Carlo, Evaluator
Allen W. Gendler, Evaluator