

Podcast Episode 5

Derrick Kyle: Welcome to the Torres Talks Trade podcast. My name is Derrick Kyle; I'm a Senior Associate at Torres Trade Law, which is a National Security and International Trade law firm. For regular listeners, you'll immediately notice whether you're watching, especially, or if you're just listening, that I'm not Olga Torres, our usual host and the Managing Member here at Torres Trade Law. But I'm very excited to be in the host chair for my first episode of the Torres Talks Trade podcast. I'm also very excited to introduce our guest today: Mr. Tony Saranchak. Hi, Tony. He's Torres Trade Advisory's Senior Customs Advisor. Tony has vast experience in both the Customs and auditing worlds, so, naturally, today we'll be discussing Customs audits. Thanks for joining us today, Tony.

Anthony Saranchak: Glad to be here.

Derrick Kyle: Customs is a hot topic these days, between the USMCA (or NAFTA 2.0) being implemented a couple years ago and tariffs on Chinese goods that have been going on for a few years now; that's involving imports. And, also more recently, forced labor issues. Like I said, it's a hot topic right now, not only in our industry world, but also in the news, you're seeing Customs. But today we're getting more to the building blocks, the basics, of Customs. So, for all of those issues, as well as a normal import program, you're going to be dealing with Customs audits. Sometimes they will be internally led, they should be, but today we're going to talk more about official U.S. Customs and Border Protection, "CBP" audits. Some people may think of it as tedious or boring, but not me. I have some questions today, and I think it's going to be helpful for some of our listeners to find out the inner workings of what the Customs audit process is about.

So, without further ado, I've already introduced Tony, but I know, Tony, that you have over a decade of experience at U.S. Customs, so if you could please describe your background. What led you to work at CBP, which is U.S. Customs and Border Protection, and your role while you were at Customs?

Anthony Saranchak: Sure, I majored in Accounting in college and then got interested in auditing, and my goal out of college was to work for the IRS. Originally, as an external audit or revenue agent, because I have that unique, weird combination of liking accounting and taxes, so, I wound up...

Derrick Kyle: That is unique.

Anthony Saranchak: I wound up working, applying for a position with the Treasury Inspector General for Tax Administration, which does internal auditing of the IRS. So, they're the watchdog of the IRS. Which many people are surprised that government agencies do get audited by someone.

Derrick Kyle: Right.

Anthony Saranchak: So that was internal auditing. I was exposed to a lot of different... it's the largest tax system in the world. So, I was exposed to a lot of different types of processing and the different internal functions that they do. And that led me to connecting and networking with other auditors in the government and I found out about Customs, and that they did external auditing, little bit of a different role but I was enticed and interested, in that they looked at, you'd be exposed to, different industries and all different types of businesses and operations all around the world. That's what kind of drew me into that and when I was there, I got promoted from an Auditor to a Team Leader, to an Assistant Field Director in charge of an Audit Group. And then, after that, I was there for 12 and a half years and got a lot of experience there, and really got hooked into that Customs work. And then I moved on to KPMG as an external consultant. So, I saw a different side of things, and then I also worked at Jones Apparel as their Customs Internal Audit Manager, so I saw yet another role and perspective of it.

Derrick Kyle: So, experience...

Anthony Saranchak: Put the whole picture together to have a lot of different experience and exposure to the different operations and different trade issues and industries.

Derrick Kyle: Experience all across the board. I think we could have an entirely separate episode just based on being part of an IRS watchdog or within the IRS internal auditing. Because I know you'd mentioned you were doing internal auditing at IRS and at first I didn't exactly know what you meant, but you're auditing the government, which is fun. But then moving to Customs, like you said, you're going to be involved with all sorts of different companies. There's a lot, at least in my opinion, as someone who's not particularly familiar with IRS audits, there's a lot of different things going on, different product groups and everything you're dealing with in the Customs audit world that maybe you weren't experiencing in the IRS.

I feel like people are more familiar, just someone you ask on the street, is more familiar with the idea of an IRS audit – your accounting, your taxes – than they

are with Customs audits, CBP audits. The question is, What's the difference? It sounds like an audit is an audit, but as far as outside of that, any particular differences that stand out between your work with the IRS and work with Customs?

Anthony Saranchak: With Customs, when I first started there, one subset of the audit methodology is Sampling, and when I joined Customs at that time in 1999, they were at the height of doing the Compliance Assessments. Which were very large statistical samples, multiple large statistical samples, because they were projecting any loss of revenue. And they were doing that for compliance efforts because Customs got audited by GAO in the Eighties and found that the whole methodology of risk assessment and how to manage your resources was hitting the government. And so, much more emphasis was put on, you have to have documented controls and you have to make sure you're following them.

Derrick Kyle: It sounds like based on that glimpse into history a bit, there was an audit of CBP by the Government Accountability Office, and, not to say that Customs was the Wild West when it comes to its auditing, but it sounds like after that audit (it's interesting for a regulatory agency), but there was more regulation of the audit process.

Anthony Saranchak: Yes.

Derrick Kyle: Okay, and that led to different kinds of audits, or shifting away from the previous type of audit more into what Customs is doing now in modern times.

Anthony Saranchak: Well, what has happened is, it's kind of come full circle because I was at Customs long enough that I got exposure to some people that were there for a while that were with Regulatory Audit, like from the beginning of time in the early Seventies.

Derrick Kyle: People stay in the government.

Anthony Saranchak: It's interesting how it's come full circle from the Seventies to now. In the Seventies, early Eighties, it was pretty much up to the local audit offices within Customs, their discretion on what entities, what importers to audit. There was no structured process until GAO came along.

Derrick Kyle: Yeah.

Anthony Saranchak: Then, they had this very structured audit process, Compliance Assessments, to help gather all these trade stats that they wanted and that were helpful to them. And over time, they had all that information and information from other areas that they kind of cut back on how many of those larger audits they were doing, and part of that was they also initiated the Importer Self-Assessment [“ISA”] Program.

The Compliance Assessment process had a very structured audit selection methodology. It was based on, someone in headquarters crunched all the trade stats for these importers and they were ranking them and listing them by giving them a risk number and we just started at the top one and started working down every year. And eventually we were getting through the bigger companies and more companies with Customs were applying for the ISA. So, we were getting down to the medium and smaller corporations and these audits were just taking too long.

Derrick Kyle: Yeah.

Anthony Saranchak: On a reasonable basis for them to have to commit the resources and everything. It evolved into the Focused Assessment, which was looking at the controls first with the idea that you could sample less and the whole audit would take less time. They found, over time, that those started taking up a lot of time.

Derrick Kyle: An audit taking up time regardless of the various methods.

Anthony Saranchak: Yeah, because it's a lot more judgment and discretion involved than saying, “Does this control present a risk, or doesn't it?” It's not as simple as that, even though some of the samples were 200 entry lines for the Compliance Assessment, the value was either right or it wasn't, classification was either right or it wasn't. So, some, even though it was larger samples, part of it went faster than with the Focused Assessments. Customs things were changing and how audits were being done in the government and outside the government. Customs was, along the way, getting all these other compliance statistics that were helpful.

We're back now to, they still have the Focused Assessment, but they revised it maybe five years ago and they kind of threw it back to the Field Offices again on who they want to pick for audits and how they want to pick them.

Derrick Kyle: That's leading to the question I had for you, which, I think this is one of the most interesting, most important for those in the Customs area, those

that are running an import business or that import as part of their normal business. And, always prepared, I looked at some statistics. Over the past four years, CBP has averaged about 430 completed audits per year. That's out of hundreds of thousands of importing companies. I found some Census statistics, I think it was from 2019, showing about 225,000 importing companies. So, 430 out of 225,000 doesn't seem like just a whole lot of companies being audited, but that leads to the question. And I think you're just getting to this: how does Customs select companies for an audit?

Anthony Saranchak: Some of that, for the percentage of audits that are still Focused Assessments, they still have a structured process. They're probably looking at the larger companies, and ones that have a larger global presence to do those.

Derrick Kyle: Right. The names that people on the street will recognize. The big companies, which those statistics did also reflect that the amount of importers, and there may be hundreds of thousands of importers, but when you look at the percentage of imports, the vast majority is from large enterprises that only make up a small percentage of all the importers. So, those are going to be initially targeted.

Anthony Saranchak: And then from there, what the Local Offices do with the rest is a variety of things. It could be Customs nationwide one year focusing on a certain trade issue that they do a single-issue audit on. They might just come out and look at one particular classification issue. They might look at classification in general for an importer. Or, they might have an issue locally within the port that they want to focus on. And then...

Derrick Kyle: So, one particular product, if they're seeing maybe one importer that has classified something differently. Maybe when the Chinese tariffs came into effect, they always classified it in one certain way at this port, they're familiar with that importing company. These tariffs come out and, what do you know, now the classification is a tariff code that's not subject to the Chinese tariffs, Section 301 tariffs. That's the sort of thing for a single-issue audit, they'll pick up on those trends potentially at the port or maybe the Center for Excellence and Expertise and they will initiate a single-issue audit?

Anthony Saranchak: Yes, the Import Specialists and the Centers of Excellence officials have access to a lot of internal Customs trade stats. One thing they look for is port shopping for a classification.

Derrick Kyle: Okay.

Anthony Saranchak: And it might be, I haven't used that, heard that term used in a while, but it comes to mind with the Chinese Section 301 tariffs that, if one port's looking at that more, there might be an importer that says, "Well, we're going to bring it this other port where we know they're not looking as closely." Well, someone's going to see that eventually, and you're going to get asked about it, probably.

Derrick Kyle: Okay, and so that seems to be a situation where the interconnectedness of the entire Customs agency comes into play. Whereas maybe, previously, you could get away with that more. There weren't centers; they weren't communicating as much. Nowadays, there's a lot more communication between the ports, between the different areas. And I'm guessing communication with the audit team from the ports in those areas?

Anthony Saranchak: Yes, because the ports may make referrals to the audit teams. If they see something like that, port shopping or even if it's not like port shopping, they see your discrepancies or something that doesn't look right, not necessarily with one importer, but between the importers.

Derrick Kyle: Okay.

Anthony Saranchak: They will say, maybe both of these companies or one of them should be looked at; something's off. It's the same product, different classifications.

Derrick Kyle: Okay, let's say whatever the issue or issues are, free trade agreements, valuation, classification. For an importer, once selected for an audit, say maybe something was referred to the audit team from the port. Once selected, how does that audit process begin?

Anthony Saranchak: What happens is there's some internal planning that gets done first with any type of audit. And so the auditors already know something with internal and external data before they show up. So they kind of have in mind what they want to focus on and what they think the risks are to ask about. So that's where they're going to direct their efforts with the single issue audits. Like I said, it can be something. . . I've heard of audits that started out just with something very narrow, maybe just part of classification, and basically they had so many questions that turned into a Focused Assessment, a larger audit.

Derrick Kyle: Okay and that's good to know. You may start out with a single issue audit, but then once the audit starts, the floodgates can open.

Anthony Saranchak: Right.

Derrick Kyle: Okay, well, so this leads me. . .we'll get to preparing for an audit in just a bit, but it does lead me to a question about the difference between an audit and what we would call an investigation, and where is that line? And what's the difference there?

Anthony Saranchak: So, I mean, and that's a good point, because a lot of times some companies use those interchangeably. No one likes either one, of course; it takes up a lot of time. But there is a difference and I correct people if they start to use investigation because it's a whole different tone and scope of what's being looked for. An audit is looking for problems that might exist and the internal controls that need to be corrected. It's really about helping the process, everyone, the whole organization be more compliant. There are audits that are just operational, and efficiency audits that corporations and the government do just to make things help run better, not necessarily from a compliance or loss of revenue standpoint. And an investigation is much more specific and not about pointing fingers and blaming people; it's about correcting things, identifying problems and correcting things. Whereas an investigation is really out to find people that did something wrong or misconduct and. . .

Derrick Kyle: Okay.

Anthony Saranchak: So the scope of it, of the type of line of questionings and the outcome and impact of that is much different.

Derrick Kyle: Yeah, and just a note that we see with clients, I think you're 100% right, distinguishing between an audit and an investigation. And one big difference that we see is if you are approached and contacted about it from CBP's audit team, maybe if there's time, you do a self-assessment, and if you find violations or potential violations of, here's some legal code, 19 USC 1592, if there's negligence/gross negligence/fraud, you should definitely consider filing a prior disclosure as soon as possible because if it does switch over to be an investigation, then often you are barred from filing that prior disclosure at the point that it becomes a formal investigation. An audit is not a formal investigation, especially in that time before they find anything, before they're even on-site. So, that's just a word of caution, if you find something, there is the entire prior disclosure situation that should be considered just to provide potential mitigation for any violations that are found. I felt like I had to add my lawyer note there.

Anthony Saranchak: Right, and I should add, there is one small caveat to that for, and this is specifically for Customs audits. It's in the regs that once an audit team communicates in writing, it specifically says in writing, to a company. (So would it be an email or a memorandum or draft report that there is a finding or a problem in an area), then it's an investigation. So, it precludes a prior disclosure.

Derrick Kyle: Okay, so even more reason to conduct that quick self-assessment, if there's low-hanging fruit, once you hear about an audit and before even the audit commences and there's an opportunity for Customs or the audit team to find something. If necessary, certainly consider that prior disclosure. It's really all about timing and that trigger between audit and then any findings that create an investigation. Because if the audit team does find something that they are quite confident is a violation, it doesn't take much to put that in writing.

Anthony Saranchak: Normally, what happens is the audit team sends out a survey. They send out walkthrough transactions, and they start some discussions about what trade errors they are interested in. Companies have opportunity and look at their own operations themselves. Normally, if there's big problems they know right away if they're probably going to need a disclosure or not.

Derrick Kyle: Right, right.

Anthony Saranchak: So, it's not like the audit starts and you're pretty far through it and it's like, oh, should we do this? Most importers know; they start getting assistance from consultants or attorneys. And they pretty much, if the disclosure's going to be needed, they see that pretty quickly.

It brings up a point that Customs really encourages that; they want people, importers to be in the habit, not just to file that disclosure one time, but be in the habit as a control to keep reviewing their operations on a regular basis. Customs is not out to just levy big fines and penalties that put businesses out of business. They're out to collect, to correct a route of revenue and make sure that the laws and regulations are enforced consistently.

Derrick Kyle: Consistently, yeah, that's key. Small companies, large companies, we want to see consistency from our government, which, as a callback, is why even the IRS had a watchdog that audited the IRS. Okay, moving to a question that I think affects anyone in importing. They honestly probably dread but say they do get communication from the CBP audit team and their due for an audit; it will start in a month or two. How should that company prepare for an audit? What should the company expect during that audit?

Anthony Saranchak: It's one thing with audits is that it's going to take up a lot of time.

Derrick Kyle: Yeah, that's what people want to hear. . .that's true.

Anthony Saranchak: Responding, but you want to take that time to provide comprehensive and complete responses. If someone goes through and just does something very quick or flippant and it's very short with the answers, “Yes, we have a manual.” Well, you're going to have more follow-up questions. A little bit more for a question like “Do you have a manual?” When was it first implemented? When was it reviewed last? When was it updated last? Some additional information.

Derrick Kyle: To interject, I would like to say that is a global statement when it comes to communications with the government. Sometimes, not everyone, but we have seen in the business community, sometimes there's almost this thinking that “if I'm quick with my response, even if it's not detailed, it will speed things up.” When really, it's the reverse; it slows things down because dealing with the government, they won't say, “Oh, okay, it's a brief answer; we like that.” They will follow up; there will be more follow ups until they get the answer to the question that they asked. And like you said, a detailed answer. So obviously in the Customs audit process and any audit process, but really expanding to any dealing with the government.

Anthony Saranchak: And this ties into something that could be a precursor of our Customs audit, even like CF 28s, the Customs inquiries. You want to answer those as thoroughly as you can and request an extension if you need one because I've seen cases where someone that really didn't understand the consequences in the logistics department or the company left it to the broker to respond and their response was a better word at Customs.

Derrick Kyle: Right.

Anthony Saranchak: A big red flag.

Derrick Kyle: So that's what we tell clients: this should honestly be in your agreement with your customs brokers. Lots of great Customs brokers out there, but in the agreements, if you are contacted, or if the broker is contacted by Customs, they need to let the importer know before they communicate with Customs. So that, if necessary, the importer can develop their response strategy. If necessary, they can talk to consultants, attorneys. Maybe there's a larger issue that the broker isn't aware of, but the importer knows. So that's an excellent

point about communication. One, between the broker and Customs, and then also between the broker and the importer. The broker shouldn't have free reign to answer for the importer because they don't always know. And like you said, it may be more of an internal review at the importer. They may need some extra time to respond to that inquiry from Customs.

Anthony Saranchak: And I've seen one that looked like it was. . . Customs asked the question because there were two invoices, two different invoices submitted and the broker, the person just said, "I just need to get this off my desk," and they responded, "Yeah, it looks like double invoicing." Well, you don't say that to Customs.

Derrick Kyle: No, oh gosh.

Anthony Saranchak: And it turned out that it was a true first sale transaction, but they just didn't submit the documentation right.

Derrick Kyle: Oh, okay.

Anthony Saranchak: But someone at the broker just said, yeah, it looks like double invoicing.

Derrick Kyle: Oh, looks like fraud. Okay. So, we went on a tangent a bit on the customs broker interaction, but anything else for preparing and expectations during one of these audits from Customs?

Anthony Saranchak: The best thing is not to be afraid of it. Don't be vague with your answers or say something like broad statements you can't back up. I've heard, when I was with Customs, an importer say, "You're not going to find any errors; there's nothing wrong here." That's usually not true and Customs doesn't expect perfection. They want things managed by risk, that the biggest risks are addressed and that there are appropriate controls in place. And one of those is monitoring the broker. So they're not looking for perfection, but when you make a broad statement like that, you're probably going to get the attention of a good auditor and they're going to ask more questions and dig further.

Derrick Kyle: Right and in any sort of audit it's very rare, (I'm sure you know, more than I do.), it's very rare that there's going to be no issues that are discovered.

Anthony Saranchak: Right.

Derrick Kyle: So confidence is great, right? In most parts of life, but maybe it's overconfidence and sometimes even arrogance by the importer. Which is one kind of an attitude you wouldn't want to have when dealing with the government, but also, they're likely wrong about there not being any issues. So humbly come to Customs in that situation and answer thoroughly, answer correctly. And if you need more time, if you don't know exactly something, we always tell clients in any interactions with the government if you don't know, then say that. Get more time if necessary; don't make something up and correct it later because then you can lose trust.

Anthony Saranchak: Yes.

Derrick Kyle: Okay. So, what I'm hearing is in statements to the government, don't be overly broad. Any preparation, as far as documentation, anything that should be ready beforehand that's going to be particularly helpful or may speed up this process?

Anthony Saranchak: What to think of is, even if you don't have smaller companies, what gets a lot of people on the radar is smaller companies that all of a sudden, they have a new product that takes off, or they get bought out by a competitor. Now that brings them onto the Customs radar. So even if you don't have the resources maybe for a comprehensive manual, like you might want, or the entire resources of a Customs department, you should be thinking about. . .do your own walkthrough of transactions. And what department does this transaction touch? What decisions are being made at each point? Where is the documentation being kept? And even if you just do that in your mind, or like a table exercise that will help identify some things that that might be issues that Customs sees also. And it'll also help you if the company's growing that at the right time that someone can make the justification and say, "Hey, we need more resources for Customs compliance."

Derrick Kyle: That sounds like good advice for any review, small or large company, is basically put yourself in the shoes of that Customs audit team. What are they going to be looking for? What may they request? Get some of that ready in advance and also you'll be able to conduct a bit of a self-assessment to see the issues before Customs does. And at least you'll be prepared and maybe have an answer or a strategy for correcting already in mind.

Anthony Saranchak: And, and another big thing that follows up on that, that I'm hearing more recently, it surprised me that companies are doing; they're not looking at their own internal data. They don't have an ACE account. They're not running reports. When you look at those on a regular basis, you'll see things that

jump out that don't look right, and then they can follow up on it, and, if needed, get it corrected through the broker in a timely fashion, just in the normal administrative correction process that Customs has.

Derrick Kyle: Right, yeah, absolutely. That's something that we always have to keep top of mind and communicate to our clients. Okay, here's the question and I know it's going to be different, from company to company, give or take if you're selected for an audit, how long may that audit last?

Anthony Saranchak: That really varies. Now, some of them, if it's a single-issue audit that everything goes quick and there's no major issues. It could be like six months. If it turns into a Focused Assessment, you still might be looking at 18 to 24 months. And it's not that the audit team's there the whole time; it's off and on after a while. But the companies don't look at it from the standpoint of how many days during that two years Customs is there; that audit is open the whole time. And the clock is ticking to the importers because they know that someone, somewhere is going to be asking questions further up the line that they have to answer to. Why is it still open? What's the status of it?

Derrick Kyle: Right, tying up resources. Well, I think that's good, managing expectations. If this is, we know it's a months-long process at the very least, but it likely can turn into a years-long process. It's a lot better knowing that going into it than finding out at the 18-month mark and it's still happening, that could be the case. It's not ideal for the importer, but it is important to manage expectations. This is how long this could be going on, tying up resources, dealing with budget because of those resources, and like you said, further up into the executive committee, the C-suites, the board all knowing how long this could be going on. Okay.

Now, Tony, do you have any Customs audit horror stories, either for you as the auditor or on the audit team, or the company being audited?

Anthony Saranchak: One that more recently I had that hammers home the issue of monitoring your brokers: A smaller company that got bought out, it was a pharmaceutical, and they got bought out by a bigger U.S. company.

So, they got on Customs' radar, they got a CF 28 that they answered and they didn't have any other issues other than that one, but they initiated an internal audit. The larger purchasing company wanted to know more of what was going on compliance-wise. And what we saw is, again, they weren't looking at their data. They were relying on one of these large carriers to do classification and

everything. And they were only importing one product, but the carrier somehow was using 36 different classifications over a five-year period.

Derrick Kyle: Wow, for one product?

Anthony Saranchak: For one product. Yes.

Derrick Kyle: Yeah. All of these are internal controls: knowing your product, knowing what's happening, going back to what you said, reviewing your internal data. The government has actually made it a lot easier to access and review reports of that data. So that's good news; it's a bit more work, but it's important to do, preparing for any audit and eventual audit or upcoming audit that you know of.

So, I think it's been great information, Tony. We're running low on time. My final thoughts from what I've heard: as we know, audits, Customs audits included, can be scary, particularly if you're not prepared. I always say in normal life “Failing to plan is planning to fail,” and the same holds true for these Customs audits. Sounds like the importer should really treat this as a situation of “when, not if” they will be audited, especially these larger importers. But if you're prepared, you should be able to maybe predict some of the questions that are coming or at least know the issues you may have ahead of time. Any final thoughts on your end?

Anthony Saranchak: Just one quick final thought: even with the most comprehensive audit I did at Customs, the companies that passed still learned something they did not know before that helped them either with compliance or efficiency, saved money.

Derrick Kyle: I think that's huge. It's not just about compliance, which is obviously important. You steer clear of penalties, violations, all of that, but also for efficiency because it does come down to the bottom line, and in preparing for these audits and having your systems in place, if they are efficient, you can save the company money and that's huge.

All right. Thanks so much for joining us, Tony.

Anthony Saranchak: You're welcome.

Derrick Kyle: I think this was a great conversation. Thank you to our listeners and we hope to talk to you again soon.