ISRAEL FREE TRADE ACT (IFTA)
TECHNICAL INFORMATION FOR PRE-ASSESSMENT SURVEY (TIPS)

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PART 1 BACKGROUND

Provide guidance in performing a Pre-Assessment Survey (PAS) of the company's internal control for goods entered for preferential treatment as products of the Israel Free Trade Area (IFTA) 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, in Performance Audits published by the United States General Accounting Office, Office of Policy, September 1990; and the American Institute of Certified Public Accountant's *Statement on Auditing Standards No. 78.*

PART 2 IFTA GUIDANCE

On April 22, 1985, a free trade agreement was established between the Government of the United States of America and the Government of Israel. Public Law 99-47 entitled the U.S.-Israel Free Trade Area Implementation Act of 1985. IFTA is a special trade program authorized by the president to extend trade benefits for eligible articles of Israel for preferential treatment when entered into the U.S. and satisfying the IFTA eligibility requirements. The eligibility requirements for IFTA goods are found in General Notes (GN) 8 and 3(a)(v) of the Harmonized Tariff Schedule of the United States (HTSUS). The GN describes specific rules that are considered for IFTA preference.

GN 8 designates articles produced by Israel and GN 3(a)(v) covers specific entities including the West Bank, the Gaza Strip or a qualifying industrial zone (defined in GN 3(a)(v)(G)) as eligible to claim preference under IFTA.

Merchandise subject to IFTA preference appears in the HTSUS as "Free" in the HTSUS "Special" Rate of Duty subcolumn followed by the symbol "IL" in parenthesis. The Israel Free Trade preference is claimed on the imported good by using the symbol "IL" in the Special Program Indicator field of the Automated Commercial System (ACS) database.

Although GN 8(e) indicates regulations will be issued as necessary, to date there are no formal regulations for the IFTA.

To qualify for preferential treatment merchandise of the IFTA must:

- Be imported to the U.S. directly from Israel, the West Bank, the Gaza Strip or a "qualifying industrial zone". The direct shipment requirements are in GN 8(b)(ii) and 3(a)(v)(B).
- Meet the country of origin criteria and either: a) be merchandise wholly the growth, product or manufacture of Israel, the West Bank, the Gaza Strip or a "qualifying industrial zone"; or b) be merchandise transformed into a new or different article that has been grown, produced or manufactured in Israel, the West Bank, the Gaza Strip or a "qualifying industrial zone". The origin criteria are stated in GN 8(b)(i) and 3(a)(v)(A)(1) & (2).
- Meet the value content requirements where the sum of materials and direct cost of processing must represent not less than 35 percent of the goods' appraised value at the time it is entered. If the article includes cost or value of materials produced in the

customs territory of the United States, an amount not to exceed 15 percent of the appraised value may be applied toward determining the percentage. The percentage value content requirements are stated in GN 8(b)(iii) and 3(a)(v)(A)(2).

The term "Qualifying Industrial Zone" is a term defined in GN 3(a)(v)(G) as "any (designated) area that encompasses portions of the territory of Israel and Jordan, or Israel and Egypt."

Additional guidance may be found in:

- C.S.D. 85-25 (double substantial transformation);
- Ruling 556193, dated 12/23/91 (dual-sourcing);
- Ruling 557087, dated 7/22/93, T.D. 81-282, T.D. 78-399, and C.S.D. 80-208 (unallowable general and administrative costs); and
- Ruling 559010, dated 3/14/96 and T.D. 91-7 (treatment of components in sets).

2.1 EXAMPLES OF RED FLAG

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

- Company has insufficiently documented, poorly defined, or no internal control for accurately declaring merchandise entered as products of IFTA for Customs purposes. Examples:
  - ✓ Company does not monitor or interact with the broker on IFTA issues.
  - ✓ Company relies on one employee to handle IFTA issues, and there are poor or no management checks or balances over this employee.
- Responsible person lacks cost accounting knowledge.
- Company's import staff lacks knowledge of IFTA eligibility requirements.
- Company offers unreasonable explanations to Customs.
- Company fails to cooperate with or respond to Customs.
- Company has high turnover of people in key positions.
- Significant variance exists between the importer's data and Customs' data.
- Customs (import specialist, account manager, compliance measurement, prior audit) shows history of problems with merchandise entered as IFTA goods.
- One company representative dominates multiple phases of the IFTA process without monitoring or management oversight.
- HTSUS numbers that the company uses to enter IFTA merchandise have high compliance measurement error rates.
- Company imports from a specific exporter, or under an HTSUS number or country of origin, that have been identified by Customs because of known or suspected IFTA problems.
- Company has a large number of IFTA exporters or a large number of goods for which IFTA is claimed.
- The company does not request, maintain, or review documents supporting the qualification of IFTA imports.
- Company has a sharp increase of IFTA imports from a prior period.
- The importer claiming IFTA and the exporter producing the merchandise are related parties.
- There have been no prior audits or Customs reviews of IFTA imports.
- The profile identifies specific IFTA issues.

- The IFTA producer dual sources or obtains a material from two different countries, where only one material is a product of Israel.
- The merchandise does not have required markings to distinguish the origin.
- A declaration that assembled IFTA goods declared as wholly produced or manufactured in Israel or a "qualifying industrial zone" appears to be doubtful.
- The importer does not request, maintain, or review documents supporting the qualification of IFTA imports (e.g., value content requirements).
- Value content qualification is marginal, just meeting the 35 percent requirement, increasing the importance of accurate cost computations.
- Direct materials alone are not adequate to meet the 35 percent value content requirement, making accurate direct processing costs particularly important.
- Textiles and apparel articles imported are subject to textile restrictions.
- Amounts on cost sheets for unallowable general expenses and profit appear unusually low, indicating that allowable costs may be overstated.

2.2 EXAMPLES OF BEST PRACTICES

- Internal controls over merchandise entered for preferential treatment under the Israel Free Trade Act (IFTA):
  - ✓ Are in writing;
  - ✓ Include procedures for monitoring and feedback; and
  - ✓ Were monitored by management.
- One manager is ultimately responsible for control of the import department, including merchandise entered as IFTA goods. That manager has knowledge of Customs matters and the power to assure internal control procedures for imports are established and followed by all company departments.
- Written internal control procedures assign IFTA duties and tasks to a position rather than a person.
- The company has good interdepartmental communication regarding IFTA matters.
- The company conducts and documents periodic reviews of IFTA merchandise and uses the results to make corrections to past and present entries, and makes changes to their import operations as appropriate.
- Purchasing, Engineering, other departments, and suppliers provide sufficient descriptions of merchandise to permit a determination of IFTA eligibility.
- Internal control involves a verification process to determine that the imported merchandise qualifies for IFTA.
- Importer has procedures to obtain any required or necessary documentation to support the claim (e.g. a penalty provision on the supplier if IFTA information is not provided to Customs on demand).
- Importer maintains a database or listing of imported merchandise that would readily identify IFTA transactions.
- The importer (or the importer's agent) visits the plant in the IFTA country where the products are produced.
- The importer performs an annual review of changes to IFTA.

2.3 EXAMPLES OF DOCUMENTS AND INFORMATION TO REVIEW

- Internal control policies and procedures for ensuring IFTA eligibility.
- The company's response to the questionnaire.

- Interviews with company staff concerning actual procedures and controls specific to IFTA imports.
- Documentation that supports monitoring and verification of established and/or written internal control for IFTA imports.
- The company's documentation that supports monitoring and verification of established and written internal control for IFTA including:
  - ✓ An IFTA declaration signed by the person responsible for certifying that all information on the documentation is accurate and complete.
  - ✓ A list of goods by vendor that are products of the IFTA.
  - ✓ Invoices, specification sheets, or other documents providing a detailed description and origin of the IFTA goods.
  - ✓ Bills of Lading or other documents that show direct transport to the U.S.
  - ✓ For related or unrelated foreign vendors, bills of material listing country of origin of the materials used in production of the good.
  - ✓ Travel documents that show that the company has recently visited the IFTA manufacturer and verified the commodities are manufactured, produced, or wholly grown in Israel, the West Bank, the Gaza Strip or a "qualifying industrial zone".
  - ✓ Records from the IFTA producer supporting the company's verification for goods not wholly the growth or product of Israel, such as, cost allocation worksheets, bills of materials, product specification sheets, engineering drawings, work-in-process documents, material inventory records, purchase history reports, and/or material supplier lists.
  - ✓ Country of origin markings on products and components.
  - ✓ Manufacturer's affidavits as to country of origin of components.
  - ✓ "Where used" reports ("exploded" bills of material) showing that components underwent "double substantial transformation".
  - ✓ Accounting records supporting product cost sheets, including financial statements, post-closing trial balance, detailed chart of accounts, and general ledger detail.

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 sufficient risk to warrant proceeding to the Assessment Compliance Testing (ACT) process.

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 are 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.

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 relevant internal control over entries of IFTA products (examples of documents and information to review are listed on prior pages).

3. Determine whether the company established and follows procedures by reviewing:

   - Documentary evidence of the results of periodic internal control reviews/testing and corrective action implemented.
   - Documentary evidence (such as a log) of communication between the broker and the company on IFTA issues, including company testing of broker operations and verification that the broker followed company instructions.
   - Company-specific IFTA rulings, and evidence that they are followed.
   - Documentary evidence of intra-company communications to ensure correct information is provided to Customs.
   - Training records and materials relating to IFTA used to educate staff on Customs matters.

4. Review written policies and procedures and interview applicable company personnel to complete appropriate sections of the Worksheet for Evaluating Internal Control (WEIC) for IFTA Goods 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. Tests may be appropriate for various areas below the total IFTA level that will be reported on. For example, the company may import from several foreign companies, but testing may be necessary only for certain companies or certain products that have been identified as primary risks.

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.

3.4 EVALUATION OF PRE-ASSESSMENT SURVEY TESTING RESULTS

The following steps are guidance for determining the effectiveness of company's internal control over merchandise entered as products of IFTA.

1. Complete the WEIC for IFTA Goods to determine whether risk is acceptable or unacceptable and to 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.

Customs considers risk unacceptable when testing reveals that internal control is not sufficient or effective in providing reasonable assurance that accurate, timely, and complete declarations are reported to Customs.

2. The following will help the PAS team determine 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 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 performed quickly and without extensive effort, the team should immediately perform the substantive tests without proceeding to ACT.

3. Determine whether EET thresholds are met, or could be met, and take appropriate action.

3.5 EXAMPLES

The following examples of situations that might be encountered under the PAS are *for clarification only*.

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

Background
Commodities Inc., (CI) imports a number of articles manufactured in Israel (none are wholly a product of Israel) entered duty free. The exporter has indicated that the IFTA merchandise is produced with materials obtained from both the United States and foreign vendors. The internal control procedures listed in CI procedure manual requires that two conditions be met before purchasing. The two conditions are: 1) the buyer must secure from the IFTA vendor, at the time the purchase order is written, a general written statement regarding the content of the merchandise; and 2) the purchasing department will obtain from the vendor, as part of the purchase order, a statement that the vendor will provide Customs with detailed value content

data on demand. The purchase order statement also indicates any failure to supply Customs with the needed content information will make the IFTA vendor liable for any duty due.

The PAS team requested the IFTA vendors' material costs and allocation of direct costs of processing for eight items. The eight items represented imports from all IFTA vendors and 90 percent of the IFTA merchandise value. The producers were able to provide the requested information because of the conditions set in the purchase orders. An analysis of how the producers allocated the labor and overhead costs revealed that the allocations included some costs that were not part of the direct cost of processing. As a result of the revised allocations, one item failed to meet the 35 percent content requirements.

CI agreed with the PAS finding and quantified the loss of revenue. CI also reviewed the remaining 10 percent of the IFTA merchandise not covered by the PAS and found that they qualified for IFTA treatment. The PAS Team reviewed CI's work and confirmed its accuracy. Therefore, proceeding to ACT was not considered necessary.

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

Same as Example A above except that the purchase order for one item did not have the IFTA "documents on demand/duty for failure to provide records" provision stated on the purchase order. Although the purchase order procedure was not followed, the article was entered under IFTA preference. The company found that despite their failure to put the provisions on the purchase order, the content information was supplied to Customs on demand and the good was determined to qualify under the IFTA.

The cause for the above error was the lack of communication between departments and internal control procedures in place at the time. The company established a CIP to reinforce existing procedures and to improve communication between the departments. Therefore, proceeding to ACT was not considered necessary.

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

Same internal control procedures as in Example A, except that 16 items (two from each vendor) were selected from eight vendors for review. The PAS sample represented 52 percent of the IFTA entered value and eight of the 10 IFTA vendors.

Two of the eight vendors tested failed to provide Customs with documentary evidence for four of the 16 items. As a result, the duty free treatment for four items was denied.

It was determined that CI did not review the shipments to determine whether they qualified for IFTA preference. The broker was instructed to enter the goods as eligible for IFTA. In addition, the 48 percent of IFTA value that was not covered in the PAS testing included two vendors that were never selected for review, and additional items for the two vendors that previously failed to provide IFTA documentary evidence. CI did not agree with our findings, was unable to quantify the loss of revenue, and did not take corrective actions to ensure that the 48 percent of merchandise value not tested qualified for IFTA. As a result, the PAS team proceeded to ACT to determine potential loss of revenue on ineligible IFTA merchandise.

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

CI has the same controls as Example A above except that prior to limited PAS testing, it was discovered that written internal control procedures were not followed. CI did not follow its procedures to review merchandise for IFTA eligibility. The broker was instructed to enter the goods as eligible for IFTA.

For this example, CI is a mass merchandiser of Middle Eastern goods. CI imports from many vendors covering many HTS numbers. Due to the large volume of IFTA vendors and the broad range of IFTA merchandise, a determination of risk could not be assessed, based on a limited review of 20 items, without going to the ACT phase. Since the company did not agree to, or want to, take corrective action, proceeding to ACT to determine CI level of compliance was considered necessary.

PART 4 WORKSHEET FOR EVALUATING INTERNAL CONTROL (WEIC) – ISRAEL FREE TRADE AREA (IFTA)

PURPOSE: To determine whether IFTA 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?	
	Overall Controls					
1.	Are internal controls over IFTA merchandise 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 IFTA imports?					
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.	Does the responsible person have cost accounting knowledge?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
7.	Do written internal control procedures assign IFTA duties and tasks to a position rather than a person?					
8.	Does the company have good interdepartmental communication about IFTA matters?					
9.	Does the company conduct and document periodic reviews of IFTA?					
10.	Does the company use the IFTA periodic review results to make corrections to its import operations?					
11.	Does the company use the IFTA periodic reviews to make changes to its import declarations as appropriate?					
12.	Do internal controls involve a verification process to determine that the imported merchandise qualifies for IFTA?					
13.	Is adequate descriptive information provided (by Purchasing, Engineering, other departments, and suppliers) to the Import Department and/or broker to ensure proper IFTA eligibility?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
14.	Does the importer have procedures to obtain any required or necessary documentation to support the claim (e.g. a contract penalty provision if IFTA information is not provided to Customs on demand)?					
15.	Does the importer maintain an IFTA database or listing of imported merchandise that would readily identify IFTA transactions?					
16.	Does the importer (or the importer's agent) visit the plant in the IFTA country(s) where the products are produced?					
17.	Does the company perform an annual review of changes to IFTA?					
	New IFTA Merchandise					
18.	Does management review the classification and eligibility of new IFTA items?					
19.	Is responsibility for the IFTA eligibility process assigned to one knowledgeable individual or department with management oversight?					

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.	Is adequate descriptive information to ensure proper classification provided to the Import Department and/or broker by suppliers, engineers, purchasing department, etc.?					
21.	Is Customs assistance sought in classifying merchandise (e.g., requesting binding rulings)?					
	Entry Review					
22.	Does the company review entries to verify that correct classifications were used?					
23.	Does the company monitor the entry review process to verify that controls were followed?					
24.	Are suppliers required to print company provided HTSUS numbers on invoices and/or packing lists?					
25.	Does the individual reviewing merchandise have adequate knowledge and training on IFTA issues?					
26.	Are HTS classifications for IFTA maintained in a database that is provided to brokers?					

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.	Are brokers required to have written company approval to make classification changes?					
28.	Does the company provide adequate broker oversight?					
29.	Does the company identify, analyze, and manage risks related to IFTA?					
30.	Has the company identified any risks related to IFTA and implemented control mechanisms?					
31.	Does the company have internal control to address specific issues identified in the profile?					
32.	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.