

United States General Accounting Office

GAO

Testimony

122081

For Release
on Delivery
Expected at
1:30 p.m. EDT
Tuesday
October 10, 1989

Profitability of Customs Forfeiture Program
Can Be Enhanced

Statement of
Richard L. Fogel, Assistant Comptroller General
for General Government Programs

Before the
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

122081

U.S. Department of Justice
National Institute of Justice

This document has been reproduced exactly as received from the person or organization originating it. Points of view or opinions stated in this document are those of the authors and do not necessarily represent the official position or policies of the National Institute of Justice.

Permission to reproduce this ~~copyrighted~~ material has been granted by

Public Domain
U.S. General Accounting Office
to the National Criminal Justice Reference Service (NCJRS).

Further reproduction outside of the NCJRS system requires permission of the ~~copyright~~ owner.

NCJRS
FEB 28 1990
ACQUISITIONS

SUMMARY OF STATEMENT

The House Ways and Means Subcommittee on Oversight asked GAO to report on how effectively the Customs Service manages its non-cash seized assets, such as vehicles, boats, airplanes, real estate, jewelry, electronics, and textiles. Seized asset program revenues are used to help fund law enforcement efforts. GAO found that

- Calculating Customs' return from its seized asset program is difficult because of data limitations, including incomplete information on lien costs and revenues from fines and penalties. Whether the program is making money depends on whether calculations focus solely on contractor operations or include property placed in official use or transferred to state and local agencies. For the 25-month period ending June 30, 1989, GAO estimates that revenues barely cover expenses. During the first 9 months of fiscal year 1989, contractor related expenses exceeded revenues--an outright loss. However, if consideration is given to the value of property converted to public use by federal, state, and local agencies, the program provided a net gain of \$9.8 million. This net gain is on property initially valued at \$439 million--about 2 cents on the dollar. GAO believes the program can do better. Specific problems and recommended corrective actions follow.
- Expenses incurred in remissions--returning seized property to the owner--consistently exceed revenues. Remissions represent the largest category of disposals, and are growing. Expenses during the review period exceeded revenues by \$3.2 million because owners were underbilled and/or property storage costs were cancelled. Customs could reduce its remission expenses by using "constructive seizure" more often--a process whereby the owner physically retains the property but posts a bond and fulfills certain conditions concerning sale and maintenance.
- Profits from sales are declining. Sales represent the second largest disposal category. As average selling prices are declining, holding expenses are rising. Vehicles, which had the largest sales volume in fiscal year 1989, are experiencing a loss. Average profits from these sales declined from \$324 in fiscal year 1988 to an average loss of \$204 in the first three quarters of fiscal year 1989--a decline of 163 percent. Disposing of low value properties more quickly could enhance revenues. Customs has the authority to "junk" property appraised at \$1,000 or less. Raising the authorized dollar level would reduce custodial periods, thereby reducing expenses.
- Customs can further minimize the program's inherent vulnerability to fraud, waste, and abuse. Specifically, it needs to improve seizure case cost accounting; set minimum bid levels for sales of high value property; link contract fees to timely, economical disposals of property; and aggressively monitor key internal controls.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to report on our analysis of the effectiveness of the Customs Service's management of noncash assets seized from criminal enterprises.

The Trade and Tariff and Comprehensive Crime Control Acts of 1984 (Public Laws 98-573 and 473, respectively) expanded the government's seizure authority and established asset forfeiture funds at Customs and the Department of Justice. These funds can be used to finance the management and disposal of seized and forfeited assets. Profits from the seizure program can fund crime-fighting efforts of federal, state, and local law enforcement agencies. Seized property can also be used by government agencies.

Since passage of the acts, the identification, seizure, and forfeiture of the assets of drug traffickers and organized crime figures have become key parts of federal efforts to curb crime and punish criminals. The volume of seized assets, including cash, real estate, cars, boats, and airplanes has increased sharply. Today, the forfeiture program is a \$1.3 billion operation--an increase of 3,800 percent since 1979 when on-hand inventories were \$33 million dollars.

We have previously reported to Congress on cash and real

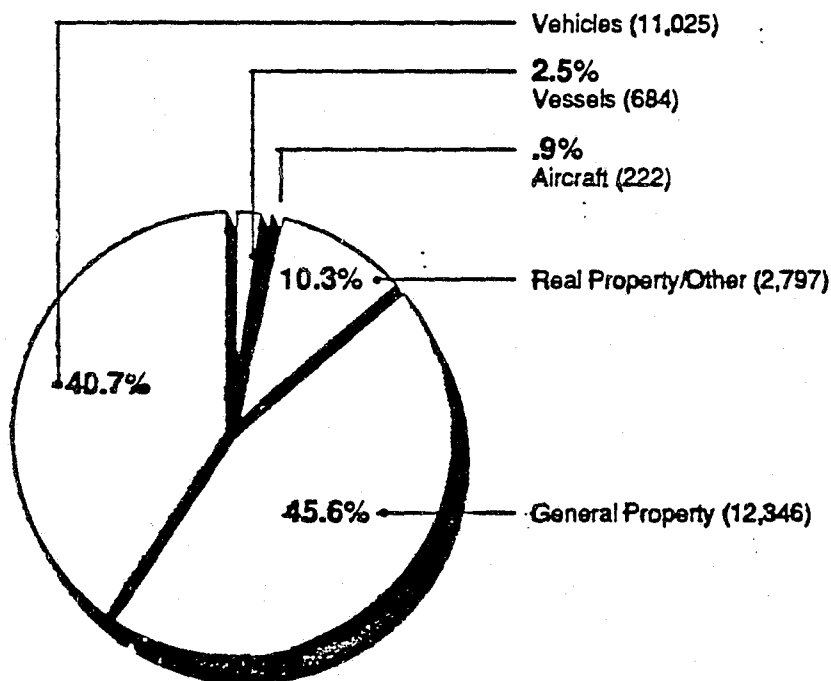
property forfeiture activity.¹ Today, we will discuss our current work on Customs' noncash seizures.

BACKGROUND ON THE SCOPE OF NONCASH SEIZURES

Noncash seizures are divided into five property categories: vehicles; boats; airplanes; real estate; and general property, which includes jewelry, art, electronic parts, and textiles.

Figure 1 shows the number of seizures disposed of by property category for the period we reviewed--June 1, 1987, to June 30, 1989.

Figure 1: Number of Disposals by Property Category, June 1, 1987 to June 30, 1989

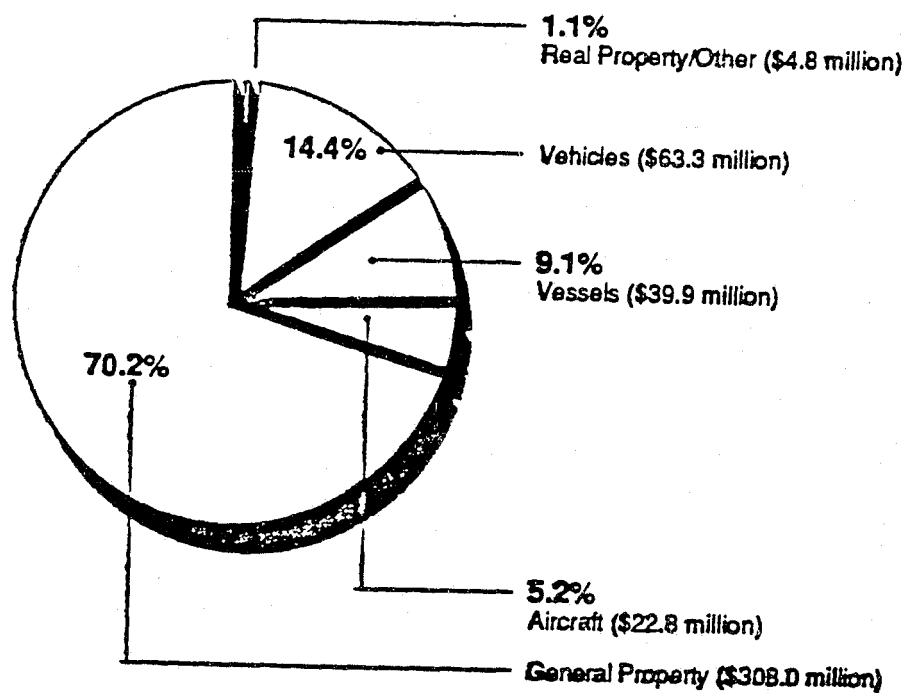


¹Asset Forfeiture: An Update (GAO/T-GGD-89-17), Testimony before the Subcommittee on Crime, Committee on the Judiciary, House of Representatives, Apr. 24, 1989.

As you can see, the general property and vehicle categories dominate Customs disposal activity.

If we examine the value of the seizures by category, as shown in figure 2, the general property category dominates, at \$308 million (70.2 percent) of total seizure value. Vehicles are distant second with a value of \$63.3 million (14.4 percent of total value).

Figure 2: Value of Disposals by Property Category,
June 1, 1987 to June 30, 1989



Seized property may be disposed of in five different ways.

First, seized property that is not forfeited may be returned to the owners through remission. Remission allows property owners to regain possession of seized property after resolving applicable fines, penalties, duties, Customs holding charges, or other Customs Service charges. Customs may remit property without requiring the owner to pay any fines or penalties upon finding that no criminal activity was involved.

Second, forfeited property may also be sold either at auction, or in some cases, by the responsible Customs Service District Director.

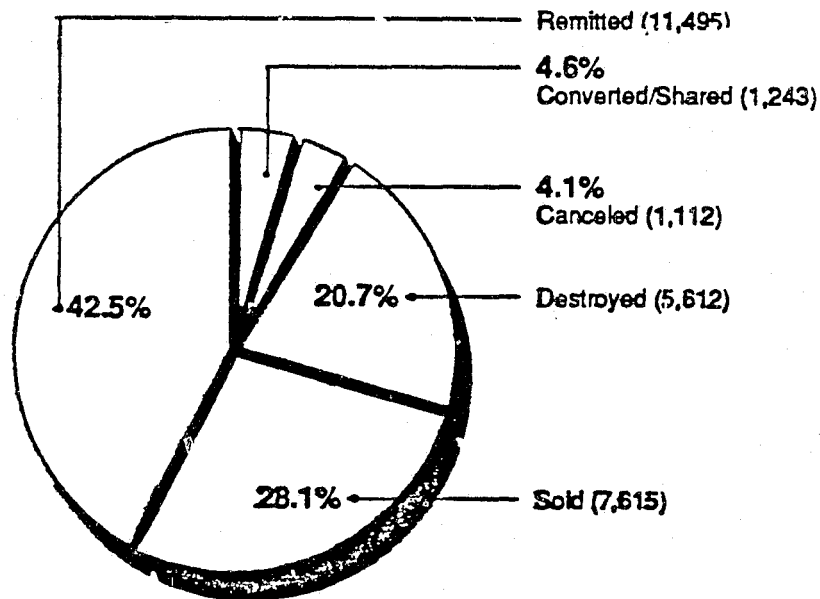
Third, seized property that is forfeited may also be disposed of by being retained for official use. Such use may be by the Customs Service or by other federal agencies. Or, when state and local law enforcement agencies assist Customs in a seizure, the item may be transferred for state and local agency use.

Fourth, Customs may destroy seized property that it determines to be unsalable.

Finally, Customs may also cancel a disposal action if the District Director finds that no legal violation has occurred.

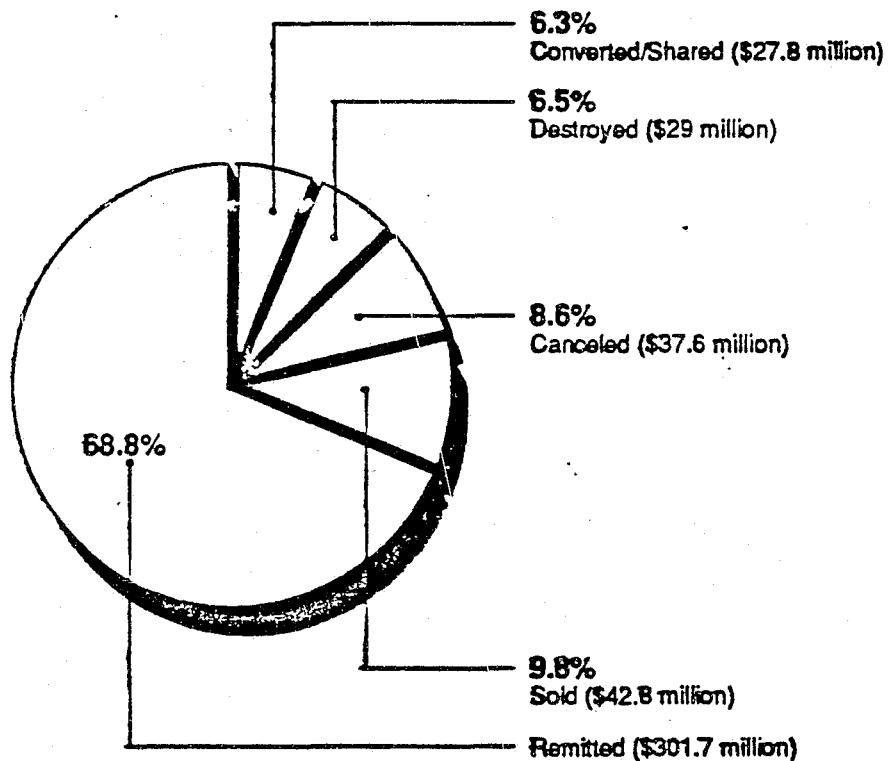
Figure 3 reports activity during the review period by method of disposition. Remission, or return to the owner, is the dominant form of property disposal, occurring 42.5 percent of the time. The sale of assets is the second most frequent method of disposition--28.1 percent--followed by destruction at 20.7 percent.

Figure 3: Number of Disposals by Type of Disposition,
June 1, 1987 to June 30, 1989



When we consider the value of property by disposition category, remissions to owner dominate, as shown in figure 4. During the review period, remissions accounted for \$301.8 million, or 68.8 percent of the total property value disposed. The next highest category--sales--accounted for just \$42.8 million, or 9.8 percent of total property values.

Figure 4: Value of Disposals by Type of Disposition,
June 1, 1987 to June 30, 1989



RETURNS FROM OPERATIONS
ARE DIFFICULT TO CALCULATE

The Subcommittee asked us to calculate the return on Customs seizure operations, including returns on specific property categories. We do have an estimate; however, it would be prudent to first describe several factors that complicate the calculation of an accurate return figure.

First, neither Customs nor its contractor (Northrop Worldwide Aircraft Services, Inc.) maintains total program costs by individual seizure--information necessary to determine net returns by specific property category. We estimated these total costs using the fragmented data available: holding costs (such as storage costs) by individual seizure and the total amounts Customs paid to the contractor for fiscal years 1987, 1988, and 1989.

Second, costs are underestimated because the contractor's data base does not maintain accurate information on liens paid or any other program costs--such as storage costs--that Customs may have paid directly. The contractor's data base has a provision for capturing such data, but Customs has not routinely reported this information to the contractor. In fact, though such data exist, Customs has not maintained them in an easily retrievable form. As it now stands, capturing direct program cost data would entail going through 27,000 case files, which represent Customs seizure activity for the period we reviewed.

Although we cannot provide a nationwide estimate of the extent to which the missing data have understated expenses, we know from our reviews of individual seizures that it can be substantial. For example, the 1988 contractor data for a boat marina sold in south Florida show that Customs realized \$859,000 from the sale.

However, when the lien costs are added in, the revenue realized drops to \$65,000.

Revenues are also understated because data on fines and penalties collected in lieu of forfeiture are also not available by seizure case. While Customs does have a system to report aggregate data on fines and penalties, Customs officials acknowledge that the system has not been effectively maintained.

Finally, revenues from the property shared with state and local law enforcement agencies or placed into official use by Customs are also understated because the financial benefit of receiving the property is not recognized. To recognize this financial benefit, we added an estimate of its value. The estimate was calculated by taking the average selling prices as a percentage of the appraised value for each class of property during the fiscal year in which it was sold. For example, all vessels sold during fiscal year 1989 returned 41.6 percent of their appraised value. Therefore, we credited vessels placed into official use or shared during fiscal year 1989 with revenues of 41.6 percent of their appraised values.

Within these limitations, we compared estimated expenses with disposal amounts--such as sales proceeds and amounts collected from remissions--to determine the revenue or loss experienced on each seizure from June 1, 1987, to June 30, 1989.

Our analysis leads us to estimate that Customs disposal operations provided \$7.2 million in returns to federal, state, and local agencies. Property appraised at \$438.9 million provided a return of 2 cents per dollar. Table 1 summarizes the returns by type of disposal.

Table 1

Disposal Results (6/87 through 6/89) (dollars in millions)

<u>Type of disposal</u>	<u>Appraised Value</u>	<u>Gross Revenues</u>	<u>Gross Expenses</u>	<u>Difference</u>
Remitted	\$301.7	\$ 4.5	\$ 7.7	(\$3.2)
Sold	42.8	17.5	10.1	7.4
Converted/shared ^{a/}	27.8	9.7	2.5	7.2
Destructions	29.0	0	1.5	(1.5)
Cancellations	37.6	0	.1	(0.1)
Total	\$438.9	\$31.7	\$21.9	\$9.8

^{a/} From June 1987 through June 1989, Customs received virtually no revenue for the property converted to official use and shared with state/local governments. We estimate, however, that Customs would have received about \$9.7 million if it had sold the property instead.

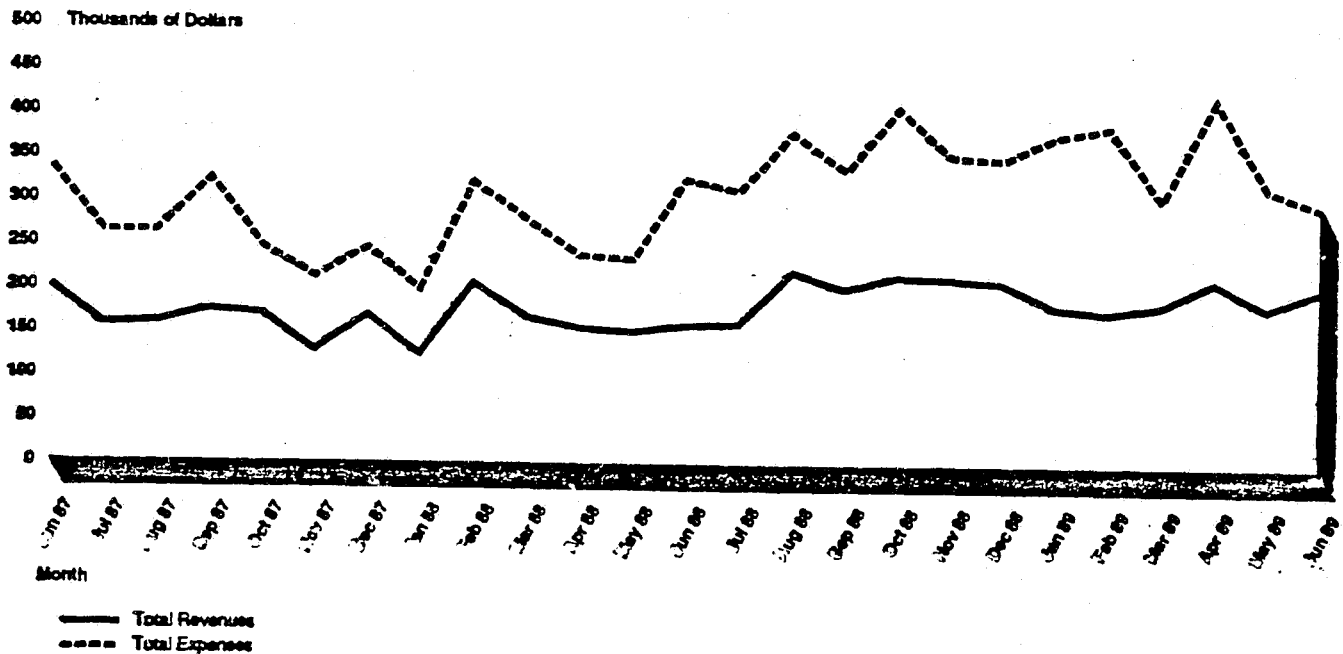
A focus solely on the results of contractor operations shows that revenues barely cover expenses by an estimated \$100,000. Further analysis shows that returns for contractor operations are declining as average revenues fall and average expenses rise. For example, in fiscal year 1988, average monthly revenues were \$905,366 and average monthly expenses were \$788,156, resulting in average monthly net revenues of \$117,000. However, during fiscal year 1989 (through May 31, 1989), average monthly revenues were \$1,010,631 and average monthly expenses were \$1,062,341, resulting in an average monthly loss of about \$52,000. To

determine why this is happening, we examined in detail revenues and expenses associated with remissions and sales--the two largest property disposal categories.

PREVENTING CUSTOMS LOSSES
ON PROPERTY RETURNED TO OWNERS

Remissions represent the largest category of disposals, and they are growing. There were 5,074 cases in fiscal year 1988. There are already 4,961 cases through the first three quarters of fiscal year 1989. At the same time, remission expenses have consistently exceeded revenues by \$3.2 million for the review period. The loss is growing. Customs incurred a loss of \$1.4 million during the first three quarters of fiscal year 1989, which exceeds the \$1.3 million lost throughout fiscal year 1988. Figure 5 shows the trend for revenues versus expenses for remissions.

Figure 5: Revenues Versus Expenses for the Remission Category, June 1, 1987 to June 30, 1989



Our work to date has identified several examples illustrating the nature of these losses. For example, 51 vessels in the Miami district were remitted during the first 9 months of fiscal year 1989, at a reported loss of \$345,000. Holding and related contract costs were reported as recovered in only two of the remissions. In 16 cases (31 percent) all costs were waived, and in 10 cases (20 percent) the amounts collected from the owners/violators were less than the holding costs.

We have identified two principal causes for these types of losses. First, the current cost method used by Customs may result in the violator being underbilled. The overhead allocation is based on a 1986 formula that understates actual

overhead expenses--Customs must absorb the difference. Second, owners or lienholders petition for and are granted relief from paying all or a portion of the storage costs. According to Customs officials, reasons for granting relief include more drug dealers using other people's cars, boats, or planes to convey their merchandise. Because the owner is not the drug dealer, the vehicles may be remitted with relief to the innocent owner.

Since remissions are growing, we are concerned that the losses may continue to mount unless corrective action is taken. One promising option is to make greater use of constructive seizure, a procedure already available to Customs District Directors. This is a "paper seizure" whereby the owner agrees to certain conditions such as (1) prohibiting the sale or mortgage of the property, and (2) maintaining the property to prevent deterioration. This technique is designed to allow Customs to avoid custodial expenses while the administrative violation leading to the seizure is adjudicated. Customs seizure policies note that constructive seizure should be considered when storage by Customs would be prohibitively expensive.

Greater clarification of the Customs constructive seizure policy is needed. Our interviews with district officials indicated that the technique is not used frequently because policy guidance on this subject is vague. Headquarters officials agree that constructive seizure should be used more often. These officials

also note that constructive seizure may need to be contingent on the owner posting bond when the property is released. This ensures that Customs will not incur losses by releasing property to the owner.

Customs is now revising its guidance on constructive seizures. However, the current revision applies only to actions taken against offenders carrying very small amounts of drugs. As a result, the new policy will affect mostly vehicle seizures. We believe that the clarification is a step in the right direction, but the policy should encompass a broader range of situations so that constructive seizures are used for all types of property. We recommend that the Secretary of Treasury direct the Customs Service to

- revise its overhead cost allocation formula to more accurately reflect actual expenses incurred;
- ensure, once the formula is revised, that all costs-- including all overhead costs--for remissions are billed to the owner, and that these costs are collected; and
- aggressively use constructive seizure, in conjunction with the posting of bonds where appropriate, on cases likely to result in remission.

PROFITS FROM SALES
ARE DECLINING

Sales of property represent the second largest disposal category, accounting for 28.1 percent of all dispositions. Over the 25-month period, about 7,600 cases have been disposed of, with a net return of \$7.4 million.

We found that declining average selling prices are reducing revenues. For example, average net returns from general property sales (the largest category of property sold) have declined from \$926 in fiscal year 1988 to \$399 in fiscal year 1989, a decline of 57 percent. Customs experience with general property sales is shown in table 2.

Table 2

Comparison of General Property Sales
(Fiscal Years 1988 and 1989)

	<u>FY88</u>	<u>FY89</u> <u>(through 6/30/89)</u>
Number Sold	1,111	1,491
Average Appraised Value	\$6,990	\$5,678
Average Selling Price	1,459	797
Average Expenses	533	398
Average Profit	926	399

Vehicle sales, the next largest property category, suffered an even greater loss in profitability. The average profit from vehicle sales declined from \$324 in fiscal year 1988 to an average loss of \$204 through the first three quarters of fiscal year 1989--a decline of 163 percent. As shown in table 3, the average vehicle selling price has declined while expenses have

risen. According to Customs officials, drug traffickers increasingly use low value vehicles to smuggle drugs, in an effort to hold down trafficker "overhead" caused by Customs seizure and forfeiture. Customs is now studying this area.

Table 3

Comparison of Vehicle Sales
(Fiscal Years 1988 and 1989)

	<u>FY88</u>	<u>FY89</u> <u>(through 6/30/89)</u>
Number Sold	1,491	2,068
Average Appraised Value	\$2,280	\$1,695
Average Selling Price	1,218	780
Average Expenses	924	984
Average Profit (loss)	324	(204)

One option for improving Customs property sales performance is to provide greater legal authority for quick disposal or "junking." Under this authority (19 USC 1612(b)), when the expenses of keeping property are disproportionately high, Customs can immediately sell or junk it--provided the property is appraised at less than \$1,000. Customs believes this amount is too low. For example, the average appraised value of the 2,068 vehicles sold in fiscal year 1989 was \$1,695. (See table 3.) As stated earlier, Customs lost an average of \$204 per vehicle due to the associated expenses of storage and sale which averaged \$984. A higher ceiling for junking property would help reduce custodial periods, thereby reducing expenses.

We recommend that Congress

-- examine the desirability of raising the authorized dollar level in Customs' quick disposal authority.

We recommend that the Secretary of the Treasury

-- upon enactment of legislation, develop, for each property category, specific dollar thresholds that would trigger use of quick sale procedures.

MAINTAINING EFFECTIVE MANAGEMENT
CONTROLS: A CRITICAL CHALLENGE

Customs' historical internal control problems have been extensively documented in a variety of public forums, including previous oversight hearings by this Subcommittee. The Secretary of the Treasury declared in his fiscal year 1988 Federal Manager's Financial Integrity Act (FMFIA) report to the President that "the Department has strong reservations concerning the effectiveness of internal controls within the U.S. Customs Service." In July 1989, the Director of the Office of Management and Budget asked all federal agencies to provide an updated status report on their respective internal control environments. In that update, the Treasury Department listed "lack of effective fund controls at the U.S. Customs Service" as one of its four "most serious" management control problems.

These problems have surfaced in the seized property management program. They have included use of a "substandard" system to account for millions of dollars in seized property and

allegations of program fraud, some of which are currently being investigated by a U.S. Attorney.

Customs has subsequently initiated actions to address many of these issues, but the situation is not fully resolved. Customs reports that, as of October 4, 1989, it has completed corrective actions in 17 areas with reported internal control problems. Actions remain to be completed in eight areas. In addition, as noted earlier, Customs is not effectively maintaining the cost information necessary for assessing program results, particularly in the area of lien costs.

It is within this overall internal control environment that Customs is now renewing its national contract for services to help run the seized property program. These services provide for custody, maintenance, and disposal of seized property, including property sales. Costs associated with these contractual services are rising, from \$12.4 million in fiscal year 1987 to a projected \$17.5 million in fiscal year 1989.

At the Subcommittee's request, we have reviewed Customs' recent request for proposals and subsequent amendment. The current request for proposals does not require a minimum bid price for sales. Setting minimum bids, usually expressed as a percentage of fair market value, serves as an internal control check for preventing the sale of property substantially below fair market

value without prior management approval. An example to support the use of a minimum bid is the case where Customs officials seized a 52-foot motor boat in Miami on July 16, 1987. Two days later the boat was appraised at \$170,000 and 8 months later sold for \$13,500--\$156,500 less than its initial appraised value and for less than 10 percent of its fair market value. Customs officials could not explain this disparity.

Customs is considering a minimum bid requirement. We support a minimum bid requirement for high value items. We do recognize, however, that the use of minimum bids for high value items may sometimes cause the government to incur additional contract costs. Therefore, this requirement should provide Customs officials flexibility by allowing them to waive the minimum bid requirement under certain conditions.

In addition, the proposed contract type is a cost-plus-award-fee. Under the contract, the contractor automatically receives a fixed-fee consisting of 2 percent of the estimated contract costs. The contractor may then earn an additional 8 percent of the estimated contract costs as its award fee. This fee is determined by a Customs evaluation of the contractor's performance in terms of the criteria set forth in the contract and the award fee plan. An award fee plan should be developed to emphasize the timely disposal of the property and minimize contract costs.

Given that the services to be carried out by this contractor are critical to maintaining effective internal controls, and that the overall fund control environment within Customs is still evolving, we recommend that the Secretary of the Treasury instruct Customs to

- consider providing a minimum bid requirement for high value items;
- link the award fee to the contractor's timely disposal of property and minimization of contract costs;
- ensure that all areas within the program that are identified ~~as vulnerable~~ to internal control risk are effectively covered by Customs' internal audit plans;
- rigorously monitor the contractor's risk management efforts, particularly efforts to avoid fraud, waste, and abuse; and
- collect accurate program cost data by seizure (including lien costs) to effectively report the financial performance of seizure and disposal operations both by type of disposal and category of property.

- - -

This completes my prepared statement. I would be pleased to respond to any questions.