

# FOREIGN TRADE ZONES (FTZ) – MANUFACTURING TECHNICAL INFORMATION FOR PRE-ASSESSMENT SURVEY (TIPS)

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## FOREIGN TRADE ZONES – MANUFACTURING TECHNICAL INFORMATION FOR PRE-ASSESSMENT SURVEY (TIPS)

Note: This guide may also be used for General Purpose Foreign Trade Zones.

### PART 1 BACKGROUND

The purpose of this document is to provide guidance in performing a Pre-Assessment Survey (PAS) of the company's internal control for merchandise entered into and removed from a Manufacturing - Foreign Trade Zone (FTZ) and evaluating the results.

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

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

### PART 2 MANUFACTURING FTZ GUIDANCE

An FTZ is a secure area operating under the supervision of U.S. Customs and Border Protection, and under the authority of the Foreign Trade Zone. FTZs are generally used to defer payment of duties until merchandise enters the United States commerce.

Manufacturing FTZs are generally single-purpose sites operating as a subzone of the grantee because the general-purpose zone cannot accommodate the manufacturing process. Merchandise in the manufacturing zone can be manipulated, manufactured, destroyed, exhibited, or temporarily removed with the proper permits.

The Foreign Trade Zones Act of 1934 as amended in 19 U.S.C. 81a through 81u establishes how zones are created, administered, and also identifies what may be done in a zone.

Title 19 CFR Part 146 establishes Customs requirements over merchandise admission, handling of the merchandise while in the zone, manipulation, manufacture, exhibition, transfer, and exportation from a zone.

The U.S. Customs Foreign Trade Zone Manual (FTZM) provides additional instructions and guidelines on Customs policy and administrative authority on zone operations. The users of the FTZM include import personnel, zone operators, grantees, and other users of the zone.

The Trade and Development Act of 2000, which became law on May 18, 2000, amended the Tariff Act of 1930, to allow all FTZs to file weekly entries for all classes of merchandise, except for merchandise that is prohibited by law. 19 USC 1484(i)

#### 2.1 EXAMPLES OF RED FLAGS

The following examples are conditions that may indicate a potential problem within the FTZ operations:

- Company has insufficiently documented, poorly defined, or no internal control over the admission and withdrawal of FTZ merchandise. Examples:
  - ✓ Company does not have a system to review, monitor, or interact with the broker on foreign trade zone issues.

- ✓ Company relies on one employee to handle FTZ issues, and there are poor or no management checks or balances over this employee.
- ✓ Company inventory control and recordkeeping system procedures manual is inadequate or inaccurate.
- ✓ Company does not have control procedures for zone-to-zone transfer.
- Company staff lacks knowledge of FTZ requirements and the manufacturing process of the company.
- Company offers unreasonable explanations to Customs.
- Company fails to cooperate or respond to Customs.
- Company has high turnover of people in key positions.
- A significant variance exists between the importer's data submitted to Customs and their imported data.
- Customs (e.g. spot checks, compliance measurement exams, prior audits, import specialist, account manager, and other Customs information) shows history of problems with the company's FTZ operations.
- Operator does not maintain adequate receiving and inventory records or other documentation to support admission, manufacturing, and removal of merchandise from the FTZ.
- The FTZ contains theft-prone merchandise and security over goods within the zone-activated areas is not adequate.
- Company does not conduct physical inventory/cycle counts at scheduled time.
- Company does not do an annual reconciliation of inventory.
- The importer failed to reconcile manifest quantities to CF 214s and report any shortages or overages to Customs.
- The information reported to Customs on CF 214 does not match operator's records and third party records.
- The FTZ operator failed to file a permit (CF 216) for manipulation and manufacturing, or the permit expired.
- The company exports a large volume directly from the FTZ.
- The company has quota/visa, restricted or antidumping/countervailing duty merchandise in the FTZ.
- The FTZ does not have appropriate signs indicating FTZ restricted area.
- The company does not have records to support value of merchandise when exported.
- The company does not have detailed description of FTZ manufacturing operations.
- The company does not document change to the FTZ merchandise.
- Inventory control does not account for domestic merchandise.
- Company does not submit duty payments for inventory shortages or entries for overages to Customs.
- Shortage payments or overage entries are significantly higher or lower than prior years.
- Excessive shortages or overages are shown on the annual reconciliation.
- Few, if any, adjustments are shown on the annual reconciliation.
- Company is unable to explain or provide records supporting adjustments on the annual reconciliation.
- No documentation is prepared or maintained for scrap or destruction.
- Company does not file Manifest Discrepancy Reports (MDRs) for shortages upon receipt into the zone.
- Company utilizes a template weekly entry estimate worksheet and does not review the worksheet to ensure the quantity covered actual production/withdrawals.

- Company co-mingles domestic and foreign merchandise. Potential exists for company to switch expensive foreign merchandise for inexpensive domestic merchandise of the same kind in the zone and to export the domestic merchandise as foreign merchandise.
- Company changes the part/serial number originally admitted into the zone due to engineering changes and retains no audit trail.
- Company requests zone designation status changes from Privilege Foreign (PF) to Non-Privilege Foreign (NPF).
- Merchandise is not removed from the zone within 5 days after the permit/entry is accepted by Customs.
- Company files entry for merchandise when it is in an intermediate stage of processing with a lower duty rate but inventory records showed merchandise was never removed from the zone. Company then admitted the same merchandise as domestic for further processing that is subject to a higher duty rate.
- Operator signed the ticket for delivery into the zone instead of the cartman.
- Company uses multiple inventory systems, including a separate one for FTZ, but does not have procedures to reconcile the various systems for completeness and accuracy.
- Company uses an inventory method not authorized by Customs and did not obtain approval.

## 2.2 EXAMPLES OF BEST PRACTICES

- Internal controls over FTZ operations:
  - ✓ Are in writing;
  - ✓ Include procedures for monitoring and feedback;
  - ✓ Are monitored by management; and
  - ✓ Include flowchart of the manufacturing process.
- One manager is responsible for control of the import department, including FTZ operations. That manager has knowledge of Customs matters and the authority to ensure internal control procedures for zone operations are established and followed by all company departments.
- The department/individual assigned to monitor compliance of the zone has the responsibility as his/her major duties and he/she has designated a backup.
- Written internal control procedures assign duties and tasks to a position rather than a person.
- Company's FTZ administrator has a broad-based knowledge and understanding of the various departments' functions and role in relation to the zone. For example, the zone administrator has a basic understanding of the process that the inventory department used to compile the year-end reconciliation.
- Company documents and keeps records of its annual system review of its inventory control and record keeping systems.
- Company performs internal/external audit or periodic review of zone operations and uses the results to make corrections to entries and changes to their import operations, as appropriate.
- Company has good interdepartmental communication about Customs matters.
- Company official involved with FTZ merchandise participates in continuing education and is provided sufficient information to determine whether merchandise is entered, controlled and removed in compliance with Customs Regulations and the FTZ grant.

- Company provides training in Customs requirements to other departments (receiving, accounting, manufacturing, and inventory) that are directly or indirectly involved in the zone operation.
- Labs, manufacturing, engineering, and other departments provide sufficient descriptions of merchandise to permit proper classification.
- Company updates its foreign trade zone procedural manual and submits to the port director any changes at the time of its implementation.
- Company seeks rulings and assistance from Customs on unfamiliar issues.
- The company's engineering, manufacturing, and inventory departments include the zone administrator in their regular meeting and/or when changes to the bill of materials or processes occurred.

## 2.3 EXAMPLES OF DOCUMENTS AND INFORMATION TO REVIEW

- Internal control policies and procedures for proper FTZ operation.
- The company's latest FTZ procedures manual submitted to the Port.
- Company's response to the questionnaire.
- Interviews with company staff concerning actual procedures and controls specific to the FTZ.
- Grant of Authority from the Foreign Trade Zone Board.
- Special Zone Procedures approved by Customs (i.e., alternative export procedures, inventory methodology).
- Documentation that supports monitoring and verification of established and/or written internal control over FTZ operations, such as:
  - ✓ Documentary evidence of periodic review or testing of internal control procedures.
  - ✓ Documentary evidence of annual internal reviews of inventory control and record keeping systems.
  - ✓ Documentary evidence that the company conducts scheduled cycle counts, physical inventory, and performs an annual reconciliation.
  - ✓ Release Order.
  - ✓ CF 6043 Delivery Ticket (cartage document).
  - ✓ CF 214 Application for Foreign Trade Zone Admission and/or Status Designation.
  - ✓ CF 7512 Transportation Entry and Manifest of Goods Subject to Customs Inspection and Permit (IT, T&E, IE).
  - ✓ CF 216 Application for Manipulation, Manufacture, Exhibit, or Destruction of Merchandise in a Zone.
  - ✓ CF 7525 Shipper's Export Declaration (SED).
  - ✓ CF 3461 Immediate Delivery Application and any amendment used for Weekly Estimated Removals.
  - ✓ CF 7501 Entry Summary.
  - ✓ CF 349 Harbor Maintenance Fee Report.
  - ✓ CF 301 Customs Bond (Activity Code 4).
  - ✓ Pro-forma/Commercial invoices.
  - ✓ Certified letter to the port director of overages and shortages as a result of annual reconciliation and evidence of duty payment for shortages and entries for overages.
  - ✓ Annual Reconciliation Report and supporting inventory count records.
  - ✓ IT or cartage document.
  - ✓ Waste and scrap reports.

## 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 in place is effective.

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

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

### 3.1 RISK

#### A. Preliminary Assessment of Risk

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

#### 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 the FTZ. (Examples of documents and information to review are listed on prior page).
  3. Determine whether the company established and follows procedures. Review:
    - Documentary evidence of the results of periodic internal control reviews/testing and corrective action implemented.
    - Documentary evidence, such as a log, of communication with the broker and company departments on FTZ issues. This includes company testing of broker operations and verification that the broker followed company instructions.
    - FTZ procedures manual and all other written procedures.
    - Company FTZ rulings requested. Determine whether they are followed.
    - Documentary evidence of intra-company communications to ensure correct information is provided to Customs.
    - Training records and materials used to educate staff on Customs matters.
    - Evidence that the zone operations were in conformance with the FTZ grant of authority or meet Customs approved procedures if modifications were requested.
    - Documentary evidence that the company conducts physical inventory counts and annual reconciliation.
    - Documentary evidence that the importer accounts for waste/scrap and merchandise destruction.
    - Documentation for shortages and overages in the zone, including reports to Customs.
  4. Review written policies and procedures and interview applicable company personnel to complete appropriate sections of the Worksheet for Evaluating Internal Control (WEIC) Over Manufacturing Foreign Trade Zones 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 they probably will not be able to form an opinion based on limited PAS testing. In that case, it may be necessary to proceed immediately to the ACT process. If the PAS team believes that it can form an opinion based on limited PAS testing, test the appropriate number of controls and associated transactions using the table below.

#### **Extensiveness of Audit Tests**

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

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 the FTZ operations.

- Complete the "Worksheet for Evaluating Internal Control Over Manufacturing - FTZs" to determine whether risk determination 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.
- The following will assist the PAS team in determining whether conditions warrant proceeding to ACT.
  - Do not proceed to ACT (Revenue) 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).
    - ✓ The PAS indicated that the error was due to an isolated incident.
    - ✓ The company agrees with PAS finding(s) and agrees to quantify the actual loss of revenue within an acceptable timeframe.
  - Do not proceed to ACT (Compliance) if:**
    - ✓ The error was an isolated instance.
    - ✓ The errors were systemic and the importer agreed to develop and implement a compliance improvement plan within an acceptable timeframe.
  - Proceed to ACT (Revenue) if :**
    - ✓ Company does not have adequate internal control, and PAS indicated a material loss of revenue that cannot be quantified without statistical sampling or further review.
    - ✓ Importer will not quantify loss of revenue.



- **Proceed to ACT (Compliance) if:**
  - ✓ The company refuses to take corrective action on systemic errors, and it is necessary to calculate a compliance rate.

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 referrals should be made for enforcement action.

### 3.5 EXAMPLES

The following examples of situations that might be encountered under PAS are for clarification purposes only:

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

The company's consultant included written internal control procedures for admission to the zone in its procedural manual when it applied for activation. Certain areas of the manual were updated periodically. However, the company had several personnel changes. Interviews with company's current administrative personnel found that these individuals were not aware of the internal control procedures.

The auditor requested inventory records for the walk-through transaction using an admission selected from CF 214s. The admission did not appear in the company's inventory records. In addition, the auditor found that there were receipts recorded in the company's system that were not reported to Customs.

The company discovered that the omitted admissions were sample merchandise, merchandise purchased on credit cards, and merchandise sent free of charge. These omissions were of low value.

The auditor and the company added the value for all CF 214s for a period of three months and compared the value to the company's system. It was found that the total value reported to Customs on CF 214s was significantly higher than the total value recorded as receipts in the company's inventory system. Because these receipts were not recorded in the inventory system, no audit trail exists from admission, manufacturing, and withdrawal from the zone. The company performed a 100 percent review of the admission for the last fiscal year and tendered duties for all admissions not entered in its system. Additionally, the company established internal control procedures to ensure all admissions were properly recorded. The company also paid duties for merchandise not reported to Customs. The auditor verified the accuracy and accepted the company's work; therefore the team would not proceed to ACT for revenue.

To determine whether these controls were working, the team:

- Interviewed employees to determine whether they were familiar with the company's written procedures.
- Selected five items from CF 214, Application for Admission and:
  - ✓ Determined whether admissions were recorded in the inventory system;
  - ✓ Traced the selected admissions through the inventory system; from the time they were ordered until they were withdrawn from the zone;
  - ✓ Reviewed export documents to ensure merchandise was withdrawn for exportation.

- ✓ Reviewed Customs entries to determine whether proper value was declared and appropriate duties were paid.

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

Same situation as Example A above, except the audit team was able to verify that controls were in place and working effectively. Therefore, proceeding to ACT was not considered necessary.

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

The same situation as Example A above, except the company was not able to quantify the loss of revenue caused by failure to maintain control over FTZ merchandise. Therefore, proceeding to ACT was considered necessary.

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

Same situation in Example A above except the company disagreed with taking proper corrective action. Since the company failed to monitor compliance with Customs requirements and did not agree to take corrective action, proceeding to ACT was considered necessary.

**PART 4 WORKSHEET FOR EVALUATING INTERNAL CONTROL (WEIC) – MANUFACTURING FOREIGN TRADE ZONES**

**PURPOSE:** To determine whether manufacturing FTZ 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: <ul style="list-style-type: none"> <li>• Interviews and requesting evidence from the company and</li> <li>• Reviews of documents that provide evidence that the company completed the activity.</li> </ul>
Section 2 - Preliminary Internal Control Assessment	Use information consolidated in Section 1 to make a preliminary assessment whether internal control is strong, adequate, weak or nonexistent.
Section 3 - Sample sizes	Use the Preliminary Assessment of Risk (PAR) Level and the Preliminary Internal Control Assessment to determine the sample size for each sample.
Section 4 - Results of Sample Testing	Use information in Section 4 to record the results of PAS testing to evaluate whether internal control is effective to provide reasonable assurance of compliance.
Section 5 - Risk Opinion	Use information in section 1-4 to record the PAS opinion that risk is acceptable or unacceptable

**Section 1 – Internal Control Questions**

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
1.	Are Internal Controls over FTZ operations formally documented?					
2.	Does management approve written policies and procedures?					
3.	Is one manager responsible for control of the FTZ operations?					
4.	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?					
5.	Do written internal control procedures assign FTZ duties and tasks to a position rather than a person?					
6.	Are written policies and procedures reviewed and updated periodically?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
7.	Does the company provide a copy of their procedure manual to the port director when changes are made in the FTZ procedure manual?					
8.	Does the company have adequate communication processes related to its FTZ operations?					
9.	Does company conduct and document periodic reviews of the FTZ operations?					
10.	If weaknesses were found during internal control review, were corrective actions implemented?					
11.	Does the company identify, analyze and manager risks related to FTZ operations?					
12.	Has the company identified any risks related to FTZ operations and implemented control mechanisms?					
13.	Does the company use the periodic review results to make corrections to past and present entries?					

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.	Did the company perform an annual internal review of the inventory control and record keeping system, as required by 19 CFR 146.25?					
15.	Did the company report to the Port Director any deficiency discovered and corrective actions as a result of the annual internal review, as required by 19 CFR 146.53?					
16.	Does the individual overseeing compliance with FTZ requirements have adequate knowledge and training?					
17.	Does the zone operator (company) have good interdepartmental communication about FTZ matters?					
18.	Does the company record keeping system include a retention program and identify documents needed to support FTZ merchandise transactions?					
19.	Does the company perform scheduled physical inventory cycle counts and annual reconciliation?					
20.	Does the company maintain adequate documentation to support the admission, control and removal of FTZ merchandise?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
21.	Does the company have specific identifiers such as Unique Identifier Number (UIN) or Zone Lot Numbers (ZLN) to trace merchandise through the manufacturing process and withdrawal of the finished goods?					
22.	Does the company's system account for waste, scrap and merchandise destruction?					
23.	Does the company's system identify overages and shortages of merchandise resulting from cycle counts or annual physical inventory and ensure proper reporting to Customs?					
24.	Does the company have controls to trace merchandise from admission through manufacturing process?					
25.	Does the company use an inventory method authorized by Customs? If not, did the company obtain approval from Customs?					
26.	Does the company review CF 214s & entries prepared by brokers to ensure correctness?					
27.	Does the company provide adequate broker oversight to ensure proper FTZ declarations and data accuracy?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
28.	Does the company have adequate internal control to address specific issues identified in the profile?					
29.	List company-specific procedures 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.