NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)
AUDIT (VERIFICATION) MANUAL
CHAPTER 5 SCOPE OF NAFTA AUDITS (VERIFICATIONS)

This chapter outlines the extent of the coverage for the exporter and/or producer audits conducted by the Customs Administrations of each Party. The scope has been defined to include the verification period, coverage, identification of importers, the assessment/liquidation period and the use of recommended verification procedures.

5.1 Verification Period

For establishment of the verification periods of the other Parties, refer to the respective Annex 5, Section 5.1 at the end of this Chapter.

The period subject to audit verification would in most cases be the fiscal year of the exporter/producer.

For this period, the goods imported should be matched to the period in which the goods were produced. In those cases involving a complex production process or where there is a time lapse between the production and the importation periods, appropriate measures will be taken to reasonably satisfy this requirement.

5.2 Coverage

For determining the coverage of verifications conducted by the Customs Administrations of the other Parties, refer to the respective Annex 5, Section 5.2 at the end of this Chapter.

The scope of verifications conducted by Regulatory Audit may include all models of goods reported on the Certificate of Origin produced by that exporter/producer that are exported to the U.S. for which preferential tariff treatment is claimed.

5.3 Identification of Importers

For the purposes of identification of importers by the Customs Administrations of the other Parties, refer to the respective Annex 5, Section 5.3 at the end of this Chapter.

An important function during the initial stages of a verification is the identification and notification of all known United States importers. The current policy followed by Regulatory Audit is to query the Automated Commercial System (ACS) using the Manufacturer's Identification Number to identify U.S. importers. The United States companies who have imported goods from that exporter/producer are identified and notified in writing that the goods are under review.

5.4 Assessment/Liquidation Period

For purposes of determining the assessment/liquidation period for the other Parties, refer to the respective Annex 5, Section 5.4 at the end of this Chapter.

Results of a verification will be applied to unliquidated entries.

5.5 Recommended Verification Procedures - Verification Programs

Verification teams prepare verification programs based on factors such as the verification concerns identified during the planning and preparation phase, the complexity of the issues, and the reliability of the company's record keeping system.

Verification Programs are evolving documents, created during the planning phase and added to throughout the course of the verification as new concerns are identified or more comprehensive testing is required, based on the materiality of the costs involved.

This is not to say, however, that there are not procedures in the verification programs that can be standardized. With this in mind the following verification programs have been prepared, incorporating procedures used during the exporter and/or producer audits conducted by the Customs Administration of each Party. These procedures have been found to be useful during several verifications already conducted. The inclusion of these procedures in a verification program would of course be dependent on the risks and concerns associated with that particular situation.

Note that the following programs contain procedures that are oriented towards an on-site visit, verifying goods for which preference criterion B is applicable.

Also note that goods that fall under preference criterion B could be categorized as either non-automotive goods or automotive goods. The following programs (Chapter 5) contain the recommended verification procedures that are oriented towards verifying that a non-automotive good satisfied the rule of origin requirements

The Verification Programs contained in Chapter 5 are as follows:

A. VERIFICATION PROGRAM - NON-QUALIFYING OPERATIONS
B. VERIFICATION PROGRAM - TARIFF CLASSIFICATION VERIFICATION PROGRAMS - REGIONAL VALUE CONTENT (RVC):
C. TRANSACTION VALUE METHOD VERIFICATION PROGRAM

Sub-programs 1 through 13

1) Eligibility for the transaction value method
2) General- RVC information
3) Plant tour
4) Review of management of information system
5) Transaction value of the good
6) Originating and non-originating materials
7) Value of materials
8) Intermediate materials
9) Packaging materials and containers for retail sale
10) Packing materials and containers for shipment
11) Accessories, spare parts, and tools
12) Inventory management system
13) Calculation of the regional value content

D. NET COST METHOD VERIFICATION PROGRAM

Sub-programs 1 through 13
1) General- RVC information
2) Plant Tour

3) Review of management of information system
4) Originating and non-originating materials
5) Value of materials
6) Intermediate materials
7) Net cost calculation
 i Total Costs
 ii Excluded costs
8) Packaging materials and containers for retail sale
9) Packing materials and containers for shipment
10) Accessories, spare parts and tools
11) Inventory management system
12) Accumulation
13) Calculation of the regional value content

E. VERIFICATION PROGRAM - TRANSSHIPMENT

For additional verification programs from the other Parties, refer to the respective Annex, Section 5.5 at the end of this Chapter.

Appendix L is the verification program which contains the recommended verification procedures associated with verifying goods claimed to be wholly obtained or produced entirely in the territory of one or more of the Parties (preference criterion A).

Appendix M is the verification program which contains the recommended verification procedures associated with verifying goods claimed to be produced entirely in the territory of one or more of the Parties exclusively from originating materials (preference criterion C).

Appendix N is the verification program which contains the recommended verification procedures associated with verifying goods claimed to satisfy preference criterion D.

Appendix O is the verification program which contains the recommended verification procedures to be used in the verification of a light duty automotive good for which the motor vehicle producer has elected to average.

Appendix P is the verification program which contains the recommended verification procedures to be used in the verification of a light duty automotive good for which the motor vehicle producer has not elected to average.

Appendix Q is the verification program which contains the recommended verification procedures to be used in the verification of a heavy duty automotive good for which the motor vehicle producer has elected to average.

Appendix R is the verification program which contains the recommended verification procedures to be used in the verification of a heavy duty automotive good for which the motor vehicle producer has not elected to average.

Where applicable, the above noted verification programs for automotive goods contain procedures to verify the applicable regional value content when the provisions concerning new and refit plants are being used. As well, the programs consider the possibility of the automotive parts producers deciding to calculate RVC based on averaged costs.

- All of the above verification programs are identical and uniform for all Parties.

VERIFICATION PROGRAM A NON-QUALIFYING OPERATIONS

VERIFICATION OBJECTIVE

TO ENSURE THAT THE GOOD DOES NOT QUALIFY AS ORIGINATING BECAUSE OF MERE DILUTION WITH WATER OR ANOTHER SUBSTANCE, OR BECAUSE OF A PRODUCTION OR PRICING PRACTICE DESIGNED TO CIRCUMVENT THE RULES OF ORIGIN AS SET OUT IN CHAPTER 4 OF THE NAFTA.

VERIFICATION PROCEDURES

Note- A good shall not be considered to be an originating good where:

- there is a production/assembly operation that consists of mere dilution. For purposes of this provision, dilution consists of the mixing of a material with water or with any other substance that does not materially alter the characteristics of the material diluted. No new substance is formed as a result; or

- there is a "preponderance of evidence" that the object of a production or pricing practice was to circumvent the Rules of Origin. In regards to unacceptable production practices, circumvention consists of any alteration or process performed on goods for the purpose of circumventing the rule of origin requirements. For example, when the processing or assembling performed in the territory of another Party of the Agreement is reversed or substantially altered after the goods have been imported and such processing or assembly was not performed for any commercial purpose other than to qualify the goods for NAFTA tariff treatment, then this will be considered circumvention.

NON-QUALIFYING PRODUCTION/ASSEMBLY OPERATIONS

1. During the on-site visit, interview company personnel to understand the production/assembly operations. Are any portions of the production process performed by subcontractors? Are any portions of the production process performed, in Maquiladora programs or operations, in foreign trade zones, or in any areas controlled by Customs? Document any concerns with respect to non-qualifying production/assembly operations.

2. Obtain and review a copy of the bill of materials and any product literature. Document any concerns with respect to non-qualifying production/assembly operations.

3. Review the section of the PLANT TOUR verification sub-program within the RVC verification programs, relating to non-qualifying production/assembly operations. Address any concerns noted with respect to non-qualifying production/assembly operations.

4. Review documents related to transportation. Consider documents obtained in the E. TRANSSHIPMENT verification program. Document any concerns with respect to the finished goods being altered subsequent to importation.

5. Relying on the interviews with company personnel, the bill of materials, product literature and the plant tour, prepare a written evaluation of the non-qualifying production/assembly operation and assess the evidence gathered. Were there any potential fungible goods?

6. When completing the VALUE OF MATERIALS verification subprogram, within the RVC verification programs, note any practice that could be construed as a pricing practice that has

been implemented by the company for the purpose of circumventing the rule of origin requirements so that the exported product can qualify as originating.

7. Look for consistency in the pricing practices of the company by comparing the pricing practice of one period to that of another period within the scope of the verification through sales invoices, internal pricing practices, etc.

8. Where available review both domestic and foreign price lists of goods sold to unrelated customers during the same time period. Document any concerns.

9. Look for adjustments to sales at the end of the year and the beginning of the next year. Review subsequent adjusting journal entries or credit notes that may impact the price of the good.

10. Prepare a written evaluation of the non-qualifying pricing practice and assess the extent of evidence gathered.

CONCLUSION

11. Conclude on the results of the verification procedures for Non-qualifying Operations.

VERIFICATION PROGRAM B TARIFF CLASSIFICATION

VERIFICATION OBJECTIVE

TO ENSURE THAT ALL NON-ORIGINATING MATERIALS ARE SUFFICIENTLY TRANSFORMED IN THE NAFTA TERRITORY SO AS TO UNDERGO THE NECESSARY TARIFF CLASSIFICATION CHANGE AS REQUIRED BY THE SPECIFIC RULE OF ORIGIN APPLICABLE TO THE EXPORTED GOOD AND TO ENSURE THAT THE FINISHED GOOD AND THE NON-ORIGINATING MATERIALS USED TO PRODUCE IT ARE PROPERLY CLASSIFIED.

1. GENERAL PROCEDURES

1. Interview the person(s) responsible for tariff classification to determine how classification was determined. Inquire about and obtain any classification rulings issued by any Customs Administration.

2. Determine the responsible individual's knowledge of the tariff, their background in tariff classification, training, etc.

3. Prior to the on-site visit, and as part of the planning phase of the verification, gather the information from:

(1) PACKAGING MATERIALS AND CONTAINERS FOR RETAIL SALE verification sub-program;

(2) PACKING MATERIALS AND CONTAINERS FOR SHIPMENT verification sub-program; and,

(3) ACCESSORIES, SPARE PARTS AND TOOLS verification sub-program within the RVC verification programs to ensure that they are not included when evaluating tariff classification change requirements.

4. Obtain a copy of all Intermediate Material (IM) designations with the corresponding IM's Harmonized System (HS) Number(s). This information will be used in the INTERMEDIATE MATERIAL verification subprogram within the RVC verification programs.

5. Document the potential for fungible materials used in the production of the goods and/or any intermediate materials, while doing the verification procedures in this verification program. (If fungible materials exist, this information will be used in the verification sub-program INVENTORY MANAGEMENT SYSTEM within the RVC verification program.)

6. Obtain information from the company pertaining to the de minimis calculations when the company has applied the de minimis provision to qualify goods.

2. CLASSIFICATION OF THE FINISHED GOOD

Sub-objective:

Determine the Tariff Classification in accordance with the Harmonized System (HS) and the Rule of Origin of the finished good under verification.

7. Obtain and review documentation on the good, i.e., bill of materials, owner's manual, catalogues. public brochures, engineering specifications, etc.

8. Obtain information with respect to the production of the good from the PLANT TOUR verification sub-program with the RVC verification program to assist in identifying the correct classification number and rule of origin of the finished good.

9. Physically inspect the good under review and compare with the product literature to aid in confirming the correct tariff classification. (consider any potential of fungible goods).

10. Ensure that the goods under review is/are properly classified in any RVC information and Certificate of Origin to the tariff sub-heading level (6th digit) or tariff item level (8th digit) depending on the detail needed in the specific Rule of Origin. Compare the models of goods under review to the Certificate of Origin to ensure that any or all models are included in the automotive parts averaging election, if applicable.

11. Identify the correct rule of origin for the good, taking into account the work performed on the non-originating and originating materials.

12. Prepare a conclusion of the tariff classification declared by the company for the good under review.

3. CLASSIFICATION OF INTERMEDIATE MATERIALS

Sub-objective:

Only if the exporter declares intermediate materials, ensure that the correct Tariff Classification in accordance with the Harmonized System (HS) and applicable rule of origin have been declared for the intermediate materials used in the production process of the good under verification.

13. Obtain information concerning the transformation processes applicable to intermediate materials from the PLANT TOUR verification sub-program within the RVC verification programs.

14. Ensure that the intermediate materials declared by the company are properly classified to the tariff sub-heading level (6th digit) or to the tariff item

level (8th digit), depending on the detail needed in the Specific Rule of Origin.

15. Using the tariff classification determined above, identify the specific Rule of Origin for each intermediate material declared by the company.

16. Ensure that the materials used to produce each intermediate material meet the tariff classification change required by the Rules of Origin for that intermediate material.

17. Prepare a conclusion on the classification of the declared intermediate material(s) as to whether they are originating or non-originating. (Refer to the Net Cost RVC verification program "D", if there is an RVC requirement.)

4. CLASSIFICATION OF ORIGINATING MATERIALS

Sub-objective:

To determine the tariff classification of originating materials and to assist in other areas of the verification, specifically the identification of materials that should be the subject of supplier confirmation letters. Coordinate this review with the ORIGINATING AND NON-ORIGINATING MATERIALS sub-programs within the RVC verification programs.

18. Obtain an accurate description of the materials using such information as the supplier parts catalogue, engineering documents, supplier contracts, and by physical examination and classify the materials on the bill of materials to the tariff sub-heading level (6th digit) or the tariff item level (8th digit), depending on the detail needed in the specific rule of origin.

19. Note the source of the materials (if such information comes to your attention), using the information gathered while obtaining the description of the material. This information will be used in ORIGINATING AND NON-ORIGINATING sub-programs within the RVC verification programs.

20. Identify any materials that would not undergo the required tariff classification change if it was determined that they were non-originating. Consider these as high risk for confirmation purposes in the ORIGINATING AND NON-ORIGINATING sub-program within the RVC verification programs.

21. Using the tariff classification determined above, identify the specific Rule of Origin for the originating materials selected for confirmation purposes.

5. CLASSIFICATION OF NON-ORIGINATING MATERIALS AND TARIFF CLASSIFICATION CHANGE RULE OF ORIGIN

Sub-objective:

To verify the tariff classification of the non-originating materials and to determine whether the required tariff classification change rule has been met.

22. Obtain an accurate description of the non-originating materials using such information as the supplier parts catalogue, engineering documents, supplier contracts, and physical examination and verify the tariff classification of the non-originating materials to the tariff sub-heading level (6th digit) or the tariff item level(8th digit), depending on the detail needed in the specific Rule of

Origin. During the verification period check the consistency of the tariff classification numbers for each imported material used by the company.

NOTE: In accordance with subsection 4(8), self-produced materials may be considered non-originating for tariff shift purposes.

23. Ensure that the non-originating materials meet the tariff classification change requirements.

24. Prepare a conclusion on the classification of non-originating materials and whether the non-originating materials have met the specific tariff classification change.

VERIFICATION PROGRAM B - TARIFF CLASSIFICATION CONTINUED;

6. DE MINIMIS PROVISION

Sub-objective:

To verify whether the de minimis provision is applicable and to ensure that the de minimis calculation has been performed correctly.

25. Ensure that the de minimis provision is applicable. Is the good identified in subsection 5(4)?

26. Verify that the value of non-originating materials has been calculated in accordance with subsections 7(1) through (4) of the NAFTA Rules of Origin Regulations. Refer to the VALUE OF MATERIALS verification sub-program within the RVC verification program.

27. Where a good is subject to an RVC requirement and the de minimis provision outlined in subsection 5(5) has been applied instead of satisfying that RVC requirement, ensure the de minimis calculation is performed in accordance with 5(5)(a) of the NAFTA Rules of Origin Regulations and the good satisfies all other requirements of the Regulations. Where total cost is being used in the de minimis calculation, ensure it is being calculated in accordance with subsection 5(10) of the NAFTA

Rules of Origin Regulations.

28. For those non-originating materials that are used in the production of the good and that do not undergo an applicable change in tariff classification, and

(a) the calculation is performed in accordance with subsection 5(1), verify that the calculation is correctly performed; or

(b) the calculation is performed in accordance with subsection 5(11), request information (in writing) regarding how the calculation was performed, the period over which the Value of Non-Originating Materials (VNM) was calculated; and if Schedule X was used which method was selected. Ensure the calculation has been properly performed.

Where total cost is being used in the de minimis calculation, ensure it is being calculated in accordance with subsection 5(10) of the NAFTA Rules of Origin Regulations.

29. Prepare a conclusion as to whether the de minimis provision was applicable and performed correctly.

VERIFICATION PROGRAM C REGIONAL VALUE CONTENT - TRANSACTION VALUE METHOD

VERIFICATION OBJECTIVE

TO ENSURE THAT THE REGIONAL VALUE CONTENT REQUIREMENT, AS REQUIRED BY THE RULES OF ORIGIN, HAS BEEN MET WHERE THE TRANSACTION VALUE METHOD HAS BEEN USED.

VERIFICATION PROCEDURES

1. ELIGIBILITY FOR THE TRANSACTION VALUE METHOD.

Sub-objective:

To determine if the Transaction Value (TV) method can be applied in determining the Regional Value Content (RVC) of the good.

If one of the following items <(a) to (f)> occurs, then the RVC shall be calculated on the basis of the Net Cost Method. (Paragraph 402(5) of NAFTA)

a) There is no TV for the good (Refer to Subsection 2(1) of Schedule III of the NAFTA Rules of Origin Regulations) or where no objective or quantifiable data exists with regard to the additions required to be made to the price paid or payable under Section 4 of Schedule II of the NAFTA Rules of Origin Regulations (Refer to Subsection 4(3) of Schedule II of the Uniform Regulations);

b) The TV is unacceptable under Article 1 of the Customs Valuation Code (Refer to Subsection 2(2) of Schedule III of the NAFTA Rules of Origin Regulations) if the following occur:

b) - there are restrictions on the disposition or use of the good by the buyer other than restrictions which:

(i) are imposed or required by law or by the public authorities in the country of importation;

(ii) limit the geographical area in which the goods may be resold; or

(iii) do not substantially affect the value of the goods;

- The sale or price is subject to a condition or consideration for which a value cannot be determined with respect to the good;

- Part of the proceeds of any subsequent resale, disposal or use of the goods by the buyer will accrue directly or indirectly to the producer, and an appropriate adjustment cannot be made. (Paragraph 4 (1)(d) of Schedule II of the NAFTA Rules of Origin Regulations). Review specific documents such as general ledger, communications with client, correspondence, sales contracts, etc.;

- The producer and the buyer are related and the relationship between them influenced the price actually paid or payable; review the minutes of the shareholders board, general ledgers, sales ledger, chart of accounts, etc.;

c) The good is sold by the producer to a related person and the volume, by units of quantity, of sales of identical or similar goods, or any combination thereof, to related persons during the 6 months immediately preceding the month in which the good is sold, exceeds 85% of the producer's total sales to all persons whether or not related and regardless of location, of such goods during that period. Review the shareholders agreements, equity participation, minutes to shareholders board meetings, chart of accounts, general ledger, and sales journal;

d) The good is (i) a motor vehicle provided for in headings 87.01 or 87.02, subheading 8703.21 through 8703.90, or heading 87.04, 87.05 or 87.06; (ii) identified in Schedule IV or Schedule V of the Regulations and is for use in a motor vehicle provided for in headings 87.01 or 87.02, subheading 8703.21 through 8703.90, or heading 87.04, 87.05 or 87.06; (iii) provided for in subheading 6401.10 through 6406.10 (certain footwear); or (iv) provided for in tariff item 8469.10.40 (word processing machines);

e) The exporter or producer chooses to accumulate the RVC of the good; or

f) The good is designated as an intermediate material and is subject to a RVC requirement.

2. GENERAL - RVC

Sub-objective:

To ensure that the RVC percentage has been calculated correctly for each good subject to verification.

a) Obtain from company officials RVC information for each good under review;

b) Ensure that all calculations are correct; and that the good has met the RVC requirement based on these calculations; and

c) Consider whether the de minimis provision applies. Refer to the de minimis provision section in the B. Tariff Classification verification program.

3. PLANT TOUR

VERIFICATION SUB-OBJECTIVE

To obtain an understanding of the entire operations of the company (i.e. manufacturing, assembly, warehouse, accounting, etc.).

VERIFICATION PROCEDURES

a) Obtain an Organization Chart. Ensure all operations and or departments whose costs are included in the total cost calculation for RVC purposes have been reviewed and documented.

--Document the potential for costs to be included in total cost that should be excluded (i.e. costs not directly related to the production of the good including: sales promotion, marketing and after-sales service costs; royalties; shipping and packing costs; and non-allowable interest costs).

b) Observe and document the existence of the goods under review.

i) Confirm that the good under review is manufactured at that production facility.

ii) Identify any differences that may exist with respect to the tariff classification of the good under review.

c) Where the producer designates an intermediate material review the assembly process and observe the completed intermediate material (IM). Conclude on whether or not the IM is a self-produced material. This information will be used in 8. INTERMEDIATE MATERIALS DESIGNATION verification sub-program.

d) Observe and document any concerns with regard to any possible

Non-Qualifying Operations (i.e. unacceptable production or pricing practice used to circumvent the Rules of Origin) noted during the plant tour.

This information will be used in the Non-Qualifying Operations subprogram.

e) Observe and document the Research and Development and/or Engineering Operations.

--Document any concerns with respect to the potential allocation problems of costs not directly related to the goods included in the averaging calculation.

f) Observe and document the warehouse operations (i.e. receiving material inventory, storing material inventory and storing of finished goods).

i) Document any concerns with respect to the tariff classification of materials for which there may be classification differences.

ii) Document any concerns with respect to the ownership of material.

iii) Document any concerns with respect to the source of materials (i.e. dual sourcing, markings on materials, fungible materials, etc.) noted during the plant tour.

iv) Document any concerns with respect to the potential for costs being included in the RVC calculation that are not directly attributable to the goods under review.

v) Document any concerns with respect to the shipping of finished goods (i.e. any costs of shipping and packing that may be included in the net cost calculation).

vi) Document any concerns with respect to the inventory and turnover of finished goods.

g) Observe and document the production /manufacturing operations. Ensure each inhouse manufacturing and sub-assembly operations that are incorporated into the good under review have been documented.

i) Document any concerns with respect to the out-sourcing of manufacturing/production or sub-assembly operations. Evaluate whether assists may be provided to the out-sourced producers.

ii) Document any concerns with respect to the potential for costs being included in the RVC calculation that are not directly attributable to the good under review.

This information will be used in 6. VALUE OF MATERIALS verification sub-program.

h) Observe and document the financial accounting operations. Ensure the materials ordering, receiving, inventory flow, direct labor costing, indirect material costing and overhead allocation determination are all documented.

i) Observe and document the Management of Information System Operations. Inquire as to the type of management reports that are produced (i.e. bills of materials, production reports, labor reports, material stock reports, etc.).

This information will be used in 4. REVIEW OF MANAGEMENT OF INFORMATION SYSTEM verification sub-program.

4. REVIEW OF THE MANAGEMENT OF INFORMATION SYSTEM

VERIFICATION SUB-OBJECTIVE

To ensure the Management of Information System (MIS) used to develop the Regional Value Content calculation is reliable and accurate.

VERIFICATION PROCEDURES

a) Obtain the relevant information concerning the Management of Information System (MIS) gathered through the 3. PLANT TOUR verification sub-program. Identify the areas of concern with respect to the MIS.

b) Obtain and review the policies and procedures manual. Identify the areas of concern with respect to the MIS.

c) Obtain the independent auditor's report. Review this report to assess the reliance the auditors placed on the MIS.

d) Interview the personnel responsible for the MIS. Assess their knowledge of Electronic Data Processing (EDP) and the importance the organization places on controls within the MIS.

e) Document the MIS. Use the policies and procedures manual and the interviews with the MIS personnel as a guide.

i) Document how the Bill of Materials is created within the system. Document how the following items are entered into the system:

A)engineering documents/specifications (including changes to engineering specifications)

B)list of materials and suppliers - approved vendor listing

C)development of standards for costing purposes (i.e. materials, labor and overhead standards).

ii) Include a review of the following:

A)how are orders for the good under review entered into the system

B)what determines production for the period

C)how are production reports generated

D)how are material stock reports (i.e. KAN-BAN) and picking lists generated

E)inventory (i.e. purchase from supplier(s), receipt, transfer to production, work-in-process, finished goods, shipment of finished goods)

iii) Document how the actual costs are recorded in the system. Include a review of payments for materials inventory, direct and indirect labor, manufacturing overhead and all other costs included in the total cost calculation.

f) Document the controls inherent in the MIS (i.e. the general and application controls). Ensure adequate controls over materials inventory, production, labor, overhead, etc.

i) General Controls

Review information pertaining to the organization controls and standard operating procedures. Review the systems development and documentation controls. This includes:

A) systems development methodology;

B) programming conventions and procedures;

C) technical, management, user and auditor review and approval;

D) system testing;

E) conversion control (if applicable);

F) program change controls;

G) system documentation standards -- program documentation, operations documentation, user documentation.

Review the systems software controls. This includes:

A) handling errors;

B) program protection;

C) file protection;

D) security protection.

Document how changes are made (i.e. authorization of changes to the system).

ii) Application Controls

Review the data capture and batch data entry controls. This includes:

A) control methodology (exposures resulting from errors and irregularities, management control objectives, system objectives, role of controls in EDP systems)

B) audit trail;

C) data capture controls;

D) data entry controls.

Review the on-line entry, processing and output controls. This includes controls to ensure:

A) reliable, proper, authorized and valid transaction entry;

B) unreliable and improper data entry is detected;

C) unreliable and improper data is corrected;

D) processing is reliable, proper and authorized;

E) unreliable, improper, and unauthorized processing is detected;

F) unreliable, improper, and unauthorized processing is corrected;

G) errors detected in output are properly corrected and resubmitted to data processing on a timely basis.

5. TRANSACTION VALUE OF THE GOOD

VERIFICATION SUB-OBJECTIVE

To ensure that the transaction value of the good is properly calculated, in order to use it in the determination of the RVC.

Transaction value means the price actually paid or payable for a good adjusted to a F.O.B. (free on board at the point of direct shipment) basis.

Adjusted to a F.O.B. basis means:

a) Where the following costs are included in the transaction value of the good, deduct:

i) the costs of transporting the good after it is shipped from the point of direct shipment;

ii) the costs of unloading, loading, handling, and insurance that are associated with that transportation; and,

iii) the cost of packing materials and containers.

b) Where the following costs are not included in the transaction value of the good, add:

i) the costs of transporting the good from the place of production to the point of direct shipment;

ii) the costs of loading, unloading, handling, and insurance that are associated with that transportation; and,

iii) the costs of loading the good for shipment at the point of direct shipment.
(Refer to Sections 2, 3 and 4 of Schedule II and Section 2 of the NAFTA Rules of Origin Regulations)

VERIFICATION PROCEDURES

a) Determine the price actually paid or payable, determined in accordance with Section 3 of Schedule II of the NAFTA Rules of Origin Regulations, for the good, by reviewing Customs Documents supported by commercial invoices, purchase orders, checks, etc.; (Ensure that the following are not included in the price paid or payable: charges for construction, erection, assembly, maintenance, or technical assistance related to the good undertaken after the good has been sold to the buyer; duties and taxes paid in the country in which the buyer is located with respect to the good; the flow of dividends or other payments from the buyer to the producer that do not relate to the purchase of the good.) NOTE: costs relating to bring the value of the good to a F.O.B. basis as defined above should be considered.

b) add to the price actually paid or payable for the imported goods the following, to the extent that they are incurred by the buyer or by a related person on behalf of the buyer and are not included in the price actually paid or payable for the goods:

(Note that the verification risk for the transaction value of the good is overstatement, therefore a quick scan of the chart of accounts should be sufficient in order to ensure that the following have been added, but most of the verification work should be done in order to ensure that the following costs that have been added have in fact occurred)

VERIFICATION PROCEDURES

(i) commissions and brokerage fees, except buying commissions;

(ii) the costs of transporting the good to the producer's point of direct shipment and the costs of loading, unloading, handling and insurance that are associated with that transportation;

(iii) the cost of packaging materials and containers in which the goods are packaged for retail sale which are classified with the good under the Harmonized System;

- the value, reasonably allocated, of the following goods and services where supplied directly or indirectly to the producer by the buyer free of charge or at a reduced cost for use in connection with the production and sale of the good:

(i) a material, other than an indirect material, used in the production of the good;

(ii) tools, dies, molds and similar indirect materials used in the production of the good (a tour and quick scan of the fixed asset records will ensure the existence of the item and its value);

(iii) an indirect material used in the production of the good;

(iv) engineering, development, artwork, design work, and plans and sketches necessary for the production of the good regardless of where performed;

- the royalties related to the good, other than charges in respect of the right to reproduce the good in the territory of one or more of the NAFTA countries, that the buyer must pay directly or indirectly, as a condition of sale of the good;

- the value of any part of the proceeds of any subsequent resale, disposal or use of the good that accrues directly or indirectly to the producer.

6. ORIGINATING AND NON-ORIGINATING MATERIALS

VERIFICATION SUB-OBJECTIVE

To ensure that all originating and non-originating materials have been identified among all materials used in the production of the good.

VERIFICATION PROCEDURES

6.1 Bill of Materials (BOM)

Verify that the Bill of Materials (BOM) supplied by the exporter for the good under review includes all the materials used in the production of the good and identify any changes made throughout the verification period.

a) Obtain a copy of the company's RVC calculation for each good under review. Also obtain the BOM and any additional supporting documentation used by the exporter to prepare the RVC calculations. Recalculate the values for materials using the BOM and other supporting documentation and compare to the totals used by the company to calculate the RVC percentage.

b) Consider reviewing the policy and procedures manual for the BOM with respect to the definition of the BOM, use of the BOM, what is reported on the BOM, who and when changes are made to the BOM, etc.

c) Obtain from the 10. PACKING MATERIALS AND CONTAINERS FOR SHIPMENT verification subprogram any packing materials and containers for shipment which should not be included in the RVC calculation of the finished good. Exclude these materials from further verification work on the value of the non-originating materials.

d) To ensure that the BOM for the good is complete, compare part numbers, descriptions, and values with other company documents such as a picking list (used to obtain parts for production from inventory), engineering specifications (used to determine which materials would be required for the good), replacement parts listings and service manuals. Obtain explanations from company officials for any differences and adjust the BOM if required.

e) To ensure that the standard costs for materials on the BOM are consistent throughout the year:

i) review the company's standard costing policies;

ii) inquire of company officials if there have been any changes in the production process, BOM, or standard costs during the year;

iii) compare the BOM to another (or other) BOM(s) from a different date(s) during the year and inquire with company officials if any differences are found.

f) If more than one year is under verification, compare the BOM with a BOM of another year to determine whether there have been any significant changes in part numbers, descriptions or value of materials from one production year to the other.

g) Ensure that all verification adjustments required for materials as a result of BOM verification procedures have been recorded.

h) Conclude as to whether the BOM is complete and consistent throughout the verification period.

6.2 Source of Materials

Ensure that all non-originating materials have been identified among all materials used in the production of the good.

a) Obtain information from the exporter's policy and procedures manuals and from the 3. PLANT TOUR verification sub-program to assist in identifying the source of materials used in the production of the finished good.

b) For each good:

i) determine which materials the exporter has designated as originating;

ii) interview company officials to determine who was responsible for this decision and what procedures they used to verify the origin of the materials. Document strengths and weaknesses of the manner in which the company gathered information and has assigned origin for consideration in conducting further tests; iii) determine the responsible individual's understanding of the NAFTA, training received, knowledge of suppliers, etc.

iv) if the company has received supplier certifications to verify the source of the materials, review them, compare them to the BOM and determine if the results are adequate for verification purposes (if not it may be required to confirm these items).

c) Obtain the listing of originating materials that would not undergo the required tariff classification change if it was determined that they were non-originating from the B. TARIFF CLASSIFICATION verification program. Confirm the origin of those materials by reviewing supplier statement/Certifications, purchase orders, invoices and/or receiving documents.

d) Identify any part of the production process that may be sub-contracted and determine the origin of the resulting product.

e) Obtain a list of suppliers for all materials on the BOM of the good. For suppliers of originating materials only, perform the following verification procedures:

i) determine whether any of the suppliers have companies in a non-NAFTA country, or if the suppliers are U.S., Mexican or Canadian distributors (these suppliers will be considered high-risk items for confirmation purposes);

ii) inquire of company officials to determine whether there were any supplier changes during the verification period, i.e., for a material, did the company switch to a supplier in the NAFTA territory from a supplier outside of the NAFTA territory during the verification period (or vice versa); or from a supplier that was a producer to a supplier that is a distributor;

iii) to determine whether there are any fungible materials examine the parts and supplier lists, the Approved Vendor List and inquire as to whether the same material is sourced from both a supplier from a NAFTA country and from one of a non-NAFTA country and if they source parts from distributors. If fungible materials exist refer to the 12. INVENTORY MANAGEMENT SYSTEM verification sub-program.

f) If the exporter does not have supplier statements/Certifications, or they are not considered adequate for the verification:

i) select a sample of originating (and non-originating materials for value of material purposes) suppliers for confirmation of the source/value of materials and document the selection criteria. Factors to be considered when selecting the sample would include:

1) suppliers of originating materials identified as not undergoing a tariff classification change if it had been sourced from a non-NAFTA country (keeping in mind the possibility of applying the 7% De Minimis rule) in the B. TARIFF CLASSIFICATION verification program,

2) suppliers of high value originating materials,

3) suppliers who have plants in a non-NAFTA country,

4) suppliers who are U.S., Mexican or Canadian distributors,

5) a selection for value of materials and

6) a judgmental sample of the remaining suppliers;

ii) send out Custom's format supplier confirmations for the selected suppliers (see Appendix I) and ensure that confirmations are sent out to all suppliers of material if there is more than one supplier or if suppliers were changed during the period under review;

iii) prepare a working paper to control the confirmation process including the supplier name and address, material confirmed, date sent, date of receipt of the reply, date of the second follow-up letter, comments, source per reply, value per reply, etc.;

iv) if no response to the supplier confirmation is received, consider the material to be non-originating; and,

v) prepare a written determination pertaining the material for each supplier confirmation sent.

g) Obtain from the B. TARIFF CLASSIFICATION verification program any materials that had been designated as originating by the exporter were in fact sourced from a non-NAFTA country i.e., information from supplier catalogues and the 3. PLANT TOUR verification sub-program.

h) Select a sample of originating and non-originating materials and perform the following:

i) scan the purchase invoice, any attached shipping documents, the bank endorsement stamp on the canceled check and any related credit notes as indicators for support to the exporter's claim for the source (and value) of the material;

ii) using professional judgement, select materials from this sample to verify markings;

iii) follow up on any contradictory observations.

i) Ensure that all verification adjustments required for materials as a result of sourcing verification procedures have been recorded.

j) Conclude as to whether the sourcing of the materials is correct.

7. VALUE OF MATERIALS

VERIFICATION SUB-OBJECTIVE

To ensure that the value of non-originating materials have been calculated in accordance with NAFTA. (For Canada Customs: And ensure that the value of materials obtained from either the U.S. or Mexico has been correctly calculated in accordance with NAFTA for tariff treatment purposes.)

Section 7 of the NAFTA Rules of Origin Regulations states that except in the case of indirect materials, intermediate materials, and packing materials and containers, for purposes of calculating the RVC of a good, and for the purpose of subsection 5(1) and (5), the value of a material that is used in the production of the good shall be;

(a) where the originating or non-originating material is imported by the producer of the good into the territory of the NAFTA country in which the good is produced, the customs value of the material with respect to that importation, except where the customs value was not determined in a manner consistent with Schedule VIII of the NAFTA Rules of Origin Regulations, then the value of the material shall be determined in accordance with Schedule VIII, with respect to the importation of that material or
(b) where the originating or non-originating material is acquired by the producer of the good from another person located in the territory of the NAFTA country in which the good is produced;

i) the transaction value, determined in accordance with Subsection 2(1) of Schedule VIII, with respect to the transaction in which the producer acquired the material, or

ii) the value determined in accordance with Sections 6 through 11 of Schedule VIII, where, with respect to the transaction in which the producer acquired the material, there is no transaction value under Subsection 2(2) of that Schedule or the transaction value is unacceptable under Subsection 2(3) of that Schedule, and shall include the following costs (1) to (4) if they are not included under paragraph (a) or (b):

(1) the costs of freight, insurance and packing and all other costs incurred in transporting the material to the location of the producer;

(2) duties and taxes paid or payable with respect to the material in the territory of one or more of the NAFTA countries, other than duties and taxes that are waived, refunded, refundable or otherwise recoverable, including credit against duty or tax paid or payable;

(3) customs brokerage fees, including the cost of in-house customs brokerage services, incurred with respect to the material in the territory of one or more of the NAFTA countries;

(4) the cost of waste and spoilage resulting from the use of the material in the production of the good, minus the value of any reusable scrap or by-product;

Schedule VIII states that in determining the transaction value of a material, the following costs (5 to 9) shall be added to the price paid or payable referred to in (b) above:

(5) commissions, except buying commissions, incurred by the producer;

(6) the costs of containers incurred by the producer which, for customs purposes, are classified with the material under the Harmonized System;

(7) the value of the following elements (assists) where they are supplied directly or indirectly to the seller by the producer free of charge or at a reduced cost for use in connection with the production and sale of the material:

- a material, other than an indirect material, used in the production of the material being valued

- tools, dies, molds and similar indirect materials used in the production of the material being valued

- an indirect material (see Subparagraph 5(1)(b)(iii) of Schedule VIII)

- engineering, development, artwork, design work, and plans and sketches performed outside the territory of the NAFTA country in which the producer is located that are necessary for the production of the material being valued;

(8) the royalties related to the material, other than charges with respect to the right to reproduce the material in the territory of the NAFTA country in which the producer is located that the producer must pay directly or indirectly as a condition of sale of the material, to the extent that such royalties are not included in the price paid or payable;

(9) The value of any part of the proceeds of any subsequent disposal or use of the material that accrues directly or indirectly to the seller.

(Refer to Section 7 and Schedule VIII of the NAFTA Rules of Origin Regulations)

Note that where non-originating materials are the same as one another in all respects, including physical characteristics, quality and reputation, the value of non-originating materials may, at the choice of the producer, be determined in accordance with one of the methods set out in Schedule IX.

VERIFICATION PROCEDURES

a) Review the calculations prepared by the company including any supporting documentation, and interview company personnel for the purposes of identifying how the value of materials was calculated. Identify assumptions made by the exporter, all cost types included in the calculations, allocation procedures, and the accounts from which the information was extracted. How were price and usage variances accounted for?

b) Determine if the value for materials used by the company to calculate the RVC percentage match the values included in the BOM and verify that such values are reasonable. Are direct material costs allocated in accordance with Schedule VII of the Regulations?

c) Assess the internal controls in place to preserve the quality and accuracy of the data available by reviewing policy and procedures manuals with respect to the purchase of materials, internal auditor's reports, setting of standards and identification of variances and by performing a walk through of the purchasing and receiving function and documenting the flow of information by tracing material requisitioning, ordering, receiving and reporting, returns, accounting, and cash disbursement.

d) Determine whether there are any related suppliers by:

i) reviewing company documents, (i.e. vendor listing, annual report, organizational charts), and inquire of company officials

ii) determine whether this relationship influenced the cost of materials purchased by examining purchase contracts, invoices or other documentation and by inquiring of company officials; if possible compare the exporter's purchase price with the related company to the price paid to unrelated companies.

iii) if it is determined that the relationship has influenced the price, then the Transaction Value is unacceptable. One of the alternate methods of valuation must be used, i.e., Transaction Value of Identical or Similar Materials, or the Deductive, Computed or residual methods. (You may want to use the "test values" as set out in Schedule VIII Sub-sections 3(4) to 3(7) to ensure that the Transaction Value is acceptable in instances where there are materials bought between related parties.)

e) Determine if any of the following occurred, making the transaction value of the material unacceptable: restrictions on the disposition or use of the material by the producer other than those imposed by law; that limit the geographical area where the material may be used; or that does not substantially affect the value of the material.

f) Identify if there is any waste and spoilage from the use of non-originating materials by doing the following:

- Inquire of company officials.

- Obtain from 3. PLANT TOUR verification sub-program, indications of waste and spoilage.

- Inquire of potential value and document the system or method for valuation, if one exists. Review the system or method used for determining reusable scrap or by-products and ensure that they are deducted from the price paid for the materials (scan the general ledger for these accounts and inquire into what they relate to).

- Analyze the material price variances and if these are a result of production waste and spoilage and assess the impact on the reported value of materials.

- Ensure allocation of waste and spoilage to originating and/or non-originating materials is reasonable.

g) Identify and examine any assists.

- review purchase contracts and supplier correspondence files

- inquire of company officials

h) Select a sample of both originating and non-originating materials from the RVC information (or BOM) and document the selection criteria ensuring that high value parts are included in the sample. Coordinate with the work being done in the 6. ORIGINATING AND NON-ORIGINATING MATERIALS verification sub-program where there are confirmations and sample work done on invoices.

- trace to a sample of purchase contracts and invoices to determine the actual price paid by the exporter/producer; trace to canceled checks, credit or debit notes;

- for non-originating imported materials (and originating imported materials, if applicable), select a sample of materials to trace to Customs importation documents. Compare the value on these documents to the value identified in the RVC information and purchase invoices. Document the basis on which these materials were valued (i.e. Customs Value, Transaction Value (per Schedule VIII) etc.) and any concerns.

- calculate the difference between the actual and standard cost and compare with the price variance or variance from standard claimed by the exporter/producer; follow-up on any substantial differences;

- trace the total invoice amount to the appropriate ledgers and sub-ledgers to verify that purchases have been recorded correctly in the exporter's books and records;

- determine that costs incurred in transporting the material to the location of the producer have been identified and correctly reported. (freight, insurance, packing, etc.). If these costs are accounted separately from the invoice, you will have to trace these costs to the books and records and ensure that they are properly allocated to the material.

- determine that duty, taxes, and brokerage fees with respect to the purchase and importing of materials have been identified and correctly reported, making verification adjustments as required and identify whether the company actively takes part in a duty drawback program - if so, how has the duty drawback refund been considered (examine supporting documentation for these costs).

- determine the existence of in-house customs clerks and verify the correct allocation to the value of the materials, of the salaries of these clerks, especially in the case of non-originating materials. NOTE: While doing (h), you should look for indications of improper sourcing, or fungible materials.

i) Ensure that all verification adjustments required for materials as a result of value of materials verification procedures have been recorded.

j) Conclude as to whether the value of materials is correct and consistent throughout the verification period.

8. INTERMEDIATE MATERIALS

VERIFICATION SUB-OBJECTIVE

The objective of this section of the verification program is to review any self-produced materials including self produced packaging materials and containers, self produced accessories, spare parts and tools, designated as an intermediate material by the producer. If intermediate materials are designated by the company, and are found to qualify, 100% of that value is considered as an originating material for RVC calculation purposes.

NOTE: For purposes of calculating the RVC of the good, the producer of the good may designate as an intermediate material any self-produced material that is used in the production of the good, provided that where an intermediate material is subject to a RVC requirement no other self-produced material that is subject to a RVC requirement and is incorporated into that designated self-produced material is also designated by the producer as an intermediate material. Also, intermediate materials are goods in their own right and must therefore meet the rule of origin applicable to an intermediate material.

VERIFICATION PROCEDURES

a) Ensure that material costs related to the production of the Intermediate Material are not double counted as material costs related to the production of the final good.

b) Ensure that verification procedures have been completed with respect to:

- verifying the tariff classification of the intermediate materials;

- determining the correct rule of origin;

- ensuring that the non-originating materials used in the production of the intermediate material have undergon the required tariff classification change. Refer to B. TARIFF CLASSIFICATION verification program.

c) If the rule of origin contains a RVC requirement, perform a RVC test based on the net cost method. Complete the D. RVC NET COST METHOD verification program, treating the intermediate material as a good.

d) If more than one intermediate material has been identified, ensure that, where the intermediate material is subject to a regional value-content requirement, no other self-produced material subject to a regional value content requirement is used in the production of that intermediate material.

e) Conclude as to whether the Intermediate Material is an originating material.

9. PACKAGING MATERIALS AND CONTAINERS FOR RETAIL SALE

VERIFICATION SUB-OBJECTIVE

The objective of this section of the verification program is to ensure that packaging materials and containers in which a good is packaged for retail sale, classified under the HTS with the good that is packaged therein, are taken into consideration when determining the RVC, but disregarded when determining whether all the non-originating materials used in production of the good undergo the applicable change in tariff classification.

VERIFICATION PROCEDURES

a) Identify materials considered to be packaging materials (i.e., decorative boxes for retail sale) by:

- interviewing company personnel;
- reviewing the bill of materials

b) Do not include these materials in the procedures set out in the B. TARIFF CLASSIFICATION verification program.

Include these materials in the procedures set out in the RVC verification programs, specifically the ORIGINATING AND NONORIGINATING MATERIALS and VALUE OF MATERIALS verification sub-programs.

10. PACKING MATERIALS AND CONTAINERS FOR SHIPMENT

VERIFICATION SUB-OBJECTIVE

The objective of this section of the verification program is to identify packing materials and containers in which the good is packed in order to ensure that they are disregarded when calculating the RVC of the good as well as when determining whether the non-originating materials used in the production of the good undergo the applicable change in tariff classification.

VERIFICATION PROCEDURES

a) Identify materials considered to be packing materials and containers for shipment purposes by:

- interviewing company personnel;
- reviewing the bill of materials

b) Ensure that the value for packing materials is not included in the procedures set out in the B. TARIFF CLASSIFICATION verification program as well as the RVC verification programs, specifically the ORIGINATING AND NON-ORIGINATING MATERIALS and VALUE OF MATERIALS verification subprograms.

11. ACCESSORIES, SPARE PARTS AND TOOLS

VERIFICATION SUB-OBJECTIVE

The objective of this section of the verification program is to ensure that accessories, spare parts and tools delivered with the good are taken into consideration when determining the RVC of the good, but disregarded when determining whether all the non-originating materials used in the production of the good undergo the applicable change in tariff classification.

VERIFICATION PROCEDURES

a) Identify materials considered to be accessories, spare parts and tools

by:

- interviewing company personnel;
- reviewing the bill of materials;
- reviewing the owner's manual; and
- reviewing sales contracts.

b) Do not include these materials in the procedures set out in the B. TARIFF CLASSIFICATION verification program.

Include these materials in the procedures set out in the RVC verification programs, specifically the ORIGINATING AND NON-ORIGINATING MATERIALS and VALUE OF MATERIALS verification sub-programs.

12. INVENTORY MANAGEMENT SYSTEM

VERIFICATION SUB-OBJECTIVE

The objective of this section of the verification program is to determine if an acceptable inventory management system is in place for fungible materials and/or goods that are commingled as well as for physically segregated originating and non-originating materials used in the production of the good to identify the origin of the goods of a specific shipment. If an acceptable inventory management system does not exist, all the fungible materials must be considered non-originating for the purposes of the RVC calculation. NOTE: The existence of fungible materials does not automatically require that this section of the program be used, as the exporter/producer may wish to treat the fungible material as non-originating or withdraw the certificate of origin for the good into which the fungible material is incorporated or used.

VERIFICATION PROCEDURES

a) Using the information from the

6. ORIGINATING AND NON-ORIGINATING verification sub-program, obtain a listing of identified fungible materials.

b) If the material is dual sourced and commingled, determine the impact on the origin of the good should no inventory management system exist - that is if the material is determined to be non-originating. Evaluate the impact in terms of the tariff classification change requirement (consider the use of the de minimus provision) by reviewing the information obtained in the B. TARIFF CLASSIFICATION verification program, as well as in terms of the RVC requirements, by reviewing the information obtained in the 7. VALUE OF MATERIALS and the 13. CALCULATION OF THE RVC PERCENTAGE verification sub-programs if the impact is significant, proceed with the evaluation of

13. INVENTORY MANAGEMENT SYSTEM.

c) If originating and non-originating fungible materials (goods) exist, determine if the company used one of the following inventory management systems outlined in the NAFTA Rules of Origin Regulations - Schedule X to determine the materials originating status:
Specific Identification
FIFO
LIFO

Average Method

d) Document the inventory management system from beginning to end, (i.e., purchasing, receiving, storage of materials, removal from storage into production of goods, storage of goods and removal of goods from storage for shipment of goods).

e) If Specific Identification was used, ensure that originating and nonoriginating fungible materials (goods) were physically segregated, or ensure the existence of an origin identifier, and that inventory management records are available to substantiate that originating materials (or goods) were in fact tracked.

f) If FIFO was used, review the company's receipts and withdrawals from the inventory record system Ensure that the origin of fungible materials (goods) first received was considered to be the origin of fungible materials (goods) first withdrawn.

g) If LIFO was used, review the company's receipts and withdrawals from the inventory record system. Ensure that the origin of fungible materials (goods) last received was considered to be the origin of fungible materials (goods) first withdrawn.

h) If the average method was used, ensure that the company applied the correct materials averaging ratio provisions (in the case of fungible goods, the ratio is applied to each shipment).

i) Ensure that whichever method is chosen, including the averaging period in the case of the averaging method, it was used from the time it was chosen to the end of the fiscal year. Has the system changed since the inception of NAFTA?

j) Determine that the company correctly identified the origin and/or supplier of materials (goods) in its opening inventory by:
-Identifying, in the books of the producer, the latest receipts of fungible materials (goods) that add up to the amount of fungible materials (goods) in opening inventory at the time an inventory method is chosen. Determine the origin and/or supplier of materials that make up those receipts. Determine the origin and/or supplier of those fungible materials (goods) to be the origin of the fungible materials (goods) in opening inventory.

k) Review the inventory management system by performing compliance tests on a sample of purchase transactions. The sample should include transactions involving materials that were fungible materials (goods) at the inception of NAFTA and materials (goods) that were identified as fungible since the inception (i.e. change in supplier)

l) Is the inventory management system tested periodically? Obtain a description of periodic testing and evaluate its effectiveness.

m) Test a sample of fungible material (goods) inventories by identifying the origin of opening inventory, adding receipts/adjustments of materials (goods) and deducting withdrawals/adjustments and compare your result to the company's records. (can test a variety of periods, materials(goods), and production processes)

n) Conclude on whether the exporter/producer has an acceptable inventory management system (refer to Schedule X of the NAFTA Rules of Origin Regulations) and how these materials (goods) should be accounted for in the determination of origin of the good subject to verification.

o) Conclude on the need for an inventory management system and on whether:

1. the inventory management system used by the company meets all the requirements of Schedule X of the NAFTA Rules of Origin Regulations; or

2. the inventory management system used by the company requires improvement to meet the requirements of Schedule X of the NAFTA Rules of Origin Regulations - document the impact on the origin of the goods under review - document the weaknesses of the system; or

3. the inventory management system does not meet the requirements of Schedule X and the company can/ cannot construct the necessary inventory management system - document the impact on the origin of the goods under review.

13. CALCULATION OF THE REGIONAL VALUE CONTENT PERCENTAGE

VERIFICATION SUB-OBJECTIVE

The objective of this final stage of the verification program is to actually calculate the regional value content percentage.

VERIFICATION PROCEDURES

a) Obtain the value of all non-originating materials from the 7. VALUE OF MATERIALS verification sub-program and obtain the transaction value of the good from the 5. TRANSACTION

VALUE OF THE GOOD verification sub-program.

b) Subtract the value of all non-originating materials (including packaging, accessories, spare parts, tools) from the transaction value of the good. and

c) Divide the difference by the transaction value of the good. and

d) Multiply the result by 100

e) Conclude as to whether the good satisfies the NAFTA RVC requirement.

VERIFICATION PROGRAM D REGIONAL VALUE CONTENT - NET COST METHOD

VERIFICATION OBJECTIVE

TO VERIFY THAT THE REGIONAL VALUE CONTENT REQUIREMENT, AS REQUIRED BY THE RULES OF ORIGIN, HAS BEEN MET WHERE THE NET COST METHOD HAS BEEN USED

1. GENERAL - RVC

VERIFICATION SUB-OBJECTIVE

To ensure that the RVC percentage has been calculated correctly for each good.

VERIFICATION PROCEDURES

a) Obtain from company officials RVC information for the good(s) under review; Obtain a written statement from the company regarding their choice to average. A choice to average must include the goods averaged and the averaging period in accordance with subsection 2(7) and 6(15) of the Regulations.

b) Ensure that all calculations are correct and that the good has met the RVC requirement based on these calculations; and

c) Compare the information contained in the election of average with the RVC information.

d) Ensure the same averaging period has been used for the remainder of the producer's fiscal year.

1. GENERAL - RVC CONTINUED;

e) If the good is of a provision listed in Schedule IV of the Regulations that is for use as an after-market part; or an automotive component assembly or automotive component that is for use as an after market part; or a sub-component; or a listed material, determine if the company has elected to average under Section 12 of the Regulations. If an election has been made, using the information from the B. TARIFF CLASSIFICATION verification program, ensure that all goods of the same tariff provision are identified and, determine based on the election category, which should be included in the regional value content calculation. Identify the motor vehicle producer(s) included in the averaging calculation, and their respective fiscal years. Ensure averaging period is in accordance with paragraph 12(5)(b) of the Regulations.

g) Consider whether the de minimis provision applies. Refer to the DE MINIMIS section of the B. TARIFF CLASSIFICATION verification program.

2. PLANT TOUR

VERIFICATION SUB-OBJECTIVE

To obtain an understanding of the entire operations of the company (i.e. manufacturing, assembly, warehouse, accounting, etc.).

VERIFICATION PROCEDURES

a) Obtain an Organization Chart. Ensure all operations and or departments whose costs are included in the total cost calculation for RVC purposes have been reviewed and documented.
--Document the potential for costs to be included in total cost that should be excluded (i.e. costs not directly related to the production of the good under review including: sales promotion, marketing and after-sales service costs; royalties; shipping and packing costs; and non-allowable interest costs).

b) Observe and document the existence of the good under review.

i) Confirm the good under review is manufactured at that production facility.

ii) Identify any differences that may exist with respect to the tariff classification of the good under review.

c) Where the producer designates an intermediate material review the assembly process and observe the completed intermediate material (IM). Conclude on whether or not the IM is a self-produced material. This information will be used in 6. INTERMEDIATE MATERIALS DESIGNATION verification sub-program.

d) Observe and document any concerns with regard to any possible Non-Qualifying Operations (i.e. unacceptable production or pricing practice used to circumvent the Rules of Origin) noted during the plant tour. This information will be used in the A. NON-QUALIFYING OPERATIONS verification program.

e) Observe and document the Research and Development and/or Engineering Operations.
--Document any concerns with respect to the potential allocation problems of costs not directly related to the production of the goods under review.

f) Observe and document the warehouse operations (i.e. receiving material inventory, storing material inventory and storing of finished goods).

i) Document any concerns with respect to the tariff classification of materials for which there may be classification differences.

ii) Document any concerns with respect to the ownership of material.

iii) Document any concerns with respect to the source of materials (i.e. dual sourcing, markings on materials, fungible materials, etc.) noted during the plant tour.

iv).Document any concerns with respect to the potential for costs being included in the RVC calculation that are not directly attributable to the good under review.

v).Document any concerns with respect to the shipping of finished goods (i.e. any costs of shipping and packing that may be included in the net cost calculation).

vi) Document any concerns with respect to the inventory and turnover of finished goods. g) Observe and document the production /manufacturing operations. Ensure each in-house manufacturing and sub-assembly operations have been documented.

i). Document any concerns with respect to the out-sourcing of manufacturing/production or sub-assembly operations. Evaluate whether assists may be provided to the out-sourced producers. This information will be used in 5. VALUE OF MATERIALS verification sub-program.

ii). Document any concerns with respect to the potential for costs being included in the RVC calculation that are not directly attributable to the good under review.

h) Observe and document the financial accounting operations. Ensure the materials ordering, receiving, inventory flow, direct labor costing, indirect material costing and overhead allocation determination are all documented.

i) Observe and document the Management of Information System Operations. Inquire as to the type of management reports that are produced (i.e. bills of materials, production reports, labor reports, material stock reports, etc.). This information will be used in 3. REVIEW OF MANAGEMENT OF INFORMATION SYSTEM verification sub-program.

3. REVIEW OF THE MANAGEMENT OF INFORMATION SYSTEM

VERIFICATION SUB-OBJECTIVE

To ensure the Management of Information System (MIS) used to develop the Regional Value Content calculation is reliable and accurate.

VERIFICATION PROCEDURES

a) Obtain the relevant information concerning the Management of Information System (MIS) gathered through the 2. PLANT TOUR verification sub-program. Identify the areas of concern with respect to the MIS.

b) Obtain and review the policies and procedures manual. Identify the areas of concern with respect to the MIS.

c) Obtain the independent auditor's report. Review this report to assess the reliance the auditors placed on the MIS.

d) Interview the personnel responsible for the MIS. Assess their knowledge of Electronic Data Processing (EDP) and the importance the organization places on controls within the MIS.

e) Document the MIS. Use the policies and procedures manual and the interviews with the MIS personnel as a guide.

i) Document how the Bill of Materials is created within the system. Document how the following items are entered into the system:

A) engineering documents/specifications (including changes to engineering specifications)

B) list of materials and suppliers - approved vendor listing

C) development of standards for costing purposes (i.e. materials, labor and overhead standards)

ii) Include a review of the following:

A) how are orders for the good under review are entered into the system

B) what determines production for the period

C) how are production reports generated

D) how are material stock reports (i.e. KAN-BAN) and picking lists generated E) inventory (i.e. purchase from supplier(s), receipt, transfer to production, work-in-process, finished goods, shipment of finished goods)

iii) Document how the actual costs are recorded in the system. Include a review of payments for materials inventory, direct and indirect labor, manufacturing overhead and all other costs included in the total cost calculation.

f) Document the controls inherent in the MIS (i.e. the general and application controls). Ensure adequate controls over materials inventory, production, labor, overhead, etc.

i) General Controls

Review information pertaining to the organization controls and standard operating procedures.

Review the systems development and documentation controls. This includes:

A) systems development methodology;
B) programming conventions and procedures;
C) technical, management, user and auditor review and approval;

3. REVIEW OF THE MANAGEMENT OF INFORMATION SYSTEM CONTINUED;
D) system testing;
E) conversion control (if applicable);
F) program change controls;
G) system documentation standards -- program documentation, operations documentation, user documentation.

Review the systems software controls. This includes:
A)handling errors;
B)program protection;
C)file protection;
D)security protection.

Document how changes are made (i.e. authorization of changes to the system).

ii) Application Controls

Review the data capture and batch data entry controls. This includes:

A) control methodology (exposures resulting from errors and irregularities, management control objectives, system objectives, role of controls in EDP systems)

B)audit trail;
C)data capture controls;
D)data entry controls.

Review the on-line entry, processing and output controls. This includes controls to ensure:

A) reliable, proper, authorized and valid transaction entry;
B) unreliable and improper data entry is detected;
C) unreliable and improper data is corrected;
D) processing is reliable, proper and authorized;

3. REVIEW OF THE MANAGEMENT OF INFORMATION SYSTEM CONTINUED;
Done W/P by Ref

E) unreliable, improper, and unauthorized processing is detected;
F) unreliable, improper, and unauthorized processing is corrected;
G) errors detected in output are properly corrected and resubmitted to data processing on a timely basis.

4. ORIGINATING AND NON-ORIGINATING MATERIALS

VERIFICATION SUB-OBJECTIVE

To ensure that all originating and non-originating materials have been identified among all materials used in the production of the good. (For Canada Customs: and that the originating materials are correctly identified as obtained from either the U.S. or Mexico for tariff treatment purposes.)
Bill of Materials
Verify that the Bill of Materials (BOM) supplied by the Exporter/Producer for the good under review includes all the materials used in the production of the good and identify any changes made throughout the verification period.

VERIFICATION PROCEDURES
a) Obtain a copy of the completed RVC calculation for each good under review. Also obtain the BOM and any additional supporting documentation used by the exporter to prepare the RVC calculations. Recalculate the values for materials using the BOM and other supporting documentation and compare to the totals used by the company to calculate the RVC. Also compare the origin of materials indicated on the
BOM and other documentation to the information reported in the RVC. b) Consider reviewing the policy and procedure manual for the BOM with respect to the definition of the BOM, use of the BOM, what is reported on the BOM, who and when changes are made to the BOM, etc.

4. ORIGINATING AND NON-ORIGINATING MATERIALS CONTINUED;
c) Obtain from 9. PACKING MATERIALS AND CONTAINERS FOR SHIPMENT verification program any packing materials and containers for shipment which should not be included in the RVC
calculation of the finished good. Exclude these materials from further verification work on the origin and
value of the materials.

NOTE: Ensure that packaging materials and containers for retail sale as identified in 8. PACKAGING MATERIALS AND CONTAINERS FOR RETAIL SALE verification sub-program, and 10. ACCESSORIES, SPARE PARTS AND TOOLS verification sub-program are included in these procedures. Indirect materials are all originating materials.

d) To ensure that the BOM for the good is complete, compare part numbers, quantities (when average costs are used), descriptions, and values with other company documents such as a picking list used to obtain parts for production from inventory, engineering specifications used to determine which materials would be required for the good, replacement parts listings and service manuals. Obtain explanations from company officials for any differences and adjust the BOM if required.

e) To ensure that the standard costs for materials on the BOM are consistent throughout the verification period:

i) review the company's standard costing policies;

4. ORIGINATING AND NON-ORIGINATING MATERIALS CONTINUED;

ii) inquire of company officials if there have been any changes in the production process, BOM, or standard costs during the verification period;
iii) compare the BOM to another (or other) BOM(s) from a different date(s) during the verification period and inquire with company officials if any differences are found.

f) If more than one year is under review, compare the BOM with a BOM of another year to determine whether there have been any significant changes in part numbers, descriptions, sourcing or value of materials from one production year to the other.

g) Ensure that all verification adjustments required for materials as a result of BOM verification procedures have been recorded.

h) Conclude as to whether the BOM is complete and consistent throughout the verification period.

Source of Materials:

Ensure that all non-originating materials have been identified among all materials used in the production of the good.
a) Obtain information from the exporter's policy and procedures manuals and complete a plant tour to assist in identifying the source of materials used in the production of the finished good. Refer to the 2. PLANT TOUR verification sub-program to identify concerns noted previously.
b) For each good:

i) determine which materials the exporter has designated as originating;
ii) interview company officials to determine who was responsible for this decision and what procedures they used to verify the origin of the materials and document strengths and weaknesses of the manner in which the company gathered information and has assigned origin;
iii) determine the responsible individual's understanding of the NAFTA, training received, knowledge of suppliers, etc.

4. ORIGINATING AND NON-ORIGINATING MATERIALS CONTINUED;

iv) If the company has received supplier statements/Certifications to verify the source of the materials, review them, compare them to the BOM, and determine if they are adequate and sufficiently identify the materials and the certification period (if they are not adequate, these items may be considered high risk items for confirmation purposes)

c) Obtain a listing of originating materials that would not undergo the required tariff classification change if it was determined that they were non-originating from the B. TARIFF CLASSIFICATION verification program. Confirm the origin of these materials by reviewing supplier statements/Certifications purchase orders, invoice, and/or receiving documents.

d) Identify any part of the production process that may be sub-contracted and determine the origin of the resulting product.

e) Obtain a list of suppliers for all materials on the BOM of the good. For suppliers of originating materials only, perform the following verification procedures:

i) determine whether any of the suppliers have companies in a non-NAFTA country, or if the suppliers are U.S., Canadian or
Mexican distributors (these suppliers will be considered high-risk items for confirmation purposes);
ii) inquire of company officials to determine whether there were any supplier changes during the verification period i.e. for a
material did the company switch to a supplier in the NAFTA territory from a supplier outside of the NAFTA territory during the verification period (or vice versa) or from a supplier that was a producer to a supplier that is a distributor;
iii) to determine whether there are any fungible materials examine the parts and supplier lists, the Approved Vendor List and inquire as to whether the same material is sourced from both a supplier from a NAFTA country and from one of anon-NAFTA country and if they source parts from distributors. If fungible materials exist this information will be used in the 11. INVENTORY MANAGEMENT SYSTEM verification sub-program.

f) If the Exporter/Producer does not have supplier certifications, or they are not considered adequate for the verification:

i) Select a sample of originating and non-originating materials for value purposes. Select a sample of material suppliers for confirmation of the source/value of materials and document the selection criteria.

Factors to be considered when selecting the sample would include:
1) suppliers of originating materials which have been identified as not undergoing a tariff classification change if it had been sourced from a non-NAFTA country (keeping in mind the possibility of applying the 7% De Minimis rule). Refer to the B. TARIFF CLASSIFICATION verification program.
2) suppliers of high value originating materials,
3) suppliers who have plants in a non-NAFTA country,
4) suppliers who are U.S., Canadian, or Mexican distributors,
5) a selection for value of materials and
6) a judgmental sample of the remaining suppliers;
ii) Send out the Custom's format supplier confirmations for the selected suppliers (see Appendix I). Ensure that confirmations are sent out to all suppliers of materials if there is more than one supplier of a material or if suppliers were changed during the period under review;
iii) prepare a working paper to control the confirmation process including the supplier name and address, material confirmed, date sent, date of receipt of the reply, date of the second follow-up letter, comments, source per reply, value per reply, etc.;
iv) prepare a list of suppliers that did not respond to the confirmation, treat materials purchased from these suppliers as non-originating; and
v) prepare a written determination pertaining to the material for each supplier confirmation sent.

g) Determine whether conclusions documented in the B. TARIFF CLASSIFICATION verification program include findings that materials that had been designated as originating by the exporter were in fact sourced from a non-NAFTA country i.e. information from supplier catalogues and the 2. PLANT TOUR verification sub-program.
h) Select a sample of originating and non-originating materials and perform the following:
i) scan the purchase invoice, any attached shipping documents, the bank endorsement stamp on the canceled check and related credit notes to determine whether they support the exporter's claim for the source (and value) of the material;
ii) using professional judgment, select materials from this sample to verify markings;
iii) follow up on any contradictory observations.

i) Ensure that all verification adjustments required for materials as a result of sourcing verification procedures have been recorded.

j) Conclude as to whether the sourcing of the materials is correct.

5. VALUE OF MATERIALS

VERIFICATION SUB-OBJECTIVE

To ensure that the value of materials has been calculated in accordance with NAFTA.

Section 7 of the NAFTA Rules of Origin Regulations states that except in the case of indirect materials, intermediate materials, and packing materials and containers, for purposes of calculating the RVC of a good, and for the purpose of subsection 5(1) and (5), the value of a material that is used in the production of the good shall be;

(a) where the originating or non-originating material is imported by the producer of the good into the territory of the NAFTA country in which the good is produced, the customs value of the material with respect to that importation, except where the customs value was not determined in a manner consistent with Schedule VIII of the NAFTA Rules of Origin Regulations, then the value of the material shall be determined in accordance with Schedule VIII, with respect to the importation of that material, or

(b) where the originating or non-originating material is acquired by the producer of the good from another person located in the territory of the NAFTA country in which the good is produced,
i) the transaction value, determined in accordance with Subsection 2(1) of Schedule VIII, with respect to the transaction in which the producer acquired the material, or
ii) the value determined in accordance with Sections 6 through 11 of Schedule VIII, where, with respect to the transaction in which the producer acquired the material, there is no transaction value under Subsection 2(2) of that Schedule or the transaction value is unacceptable under Subsection 2(3) of that Schedule,

(c) and shall include the following costs (1 to 4) if they are not included under paragraph (a) or (b):

1) the costs of freight, insurance and packing and all other costs incurred in transporting the material to the location of the producer;

5. VALUE OF MATERIALS CONTINUED;

2) duties and taxes paid or payable with respect to the material in the territory of one or more of the NAFTA countries, other than duties and taxes that are waived, refunded, refundable or otherwise recoverable, including credit against duty or tax paid or payable;

3) customs brokerage fees, including the cost of in-house customs brokerage services, incurred with respect to the material in the territory of one or more of the NAFTA countries;

4) the cost of waste and spoilage resulting from the use of the material in the production of the good, minus the value of any reusable scrap or by-product;

Schedule VIII states that in determining the transaction value of a material, the following costs (5 to 9) shall be added to the price paid or payable refereed to in (b) above.

5) commissions, except buying commissions, incurred by the producer;

6) the costs of containers incurred by the producer which, for customs purposes, are classified with the material under the Harmonized System;

7) the value of the following elements (**assists**) where they are supplied directly or indirectly to the seller by the producer free of charge or at a reduced cost for use in connection with the production and sale of the material:
- a material, other than an indirect material, used in the production of the material being valued
- tools, dies, molds and similar indirect materials used in the production of the material being valued
- an indirect material (see Subparagraph 5(1)(b)(iii) of Schedule VIII)
- engineering, development, artwork, design work, and plans and sketches performed outside the territory of the NAFTA country in which the producer is located that are necessary for the production of the material being valued;

5. VALUE OF MATERIALS CONTINUED;

8) the royalties related to the material, other than charges with respect to the right to reproduce the material in the territory of the NAFTA country in which the producer is located that the producer must pay directly or indirectly as a condition of sale of the material, to the extent that such royalties are not included in the price paid or payable;

9) the value of any part of the proceeds of any subsequent disposal or use of the material that accrues directly
or indirectly to the seller.

(Refer to section 7 of Schedule VIII of the NAFTA Rules of Origin Regulations and Chapter 4 of the NAFTA)

Note that where non-originating materials are the same as one another in all respects, including physical characteristics, quality and reputation, the value of non-originating materials may, at the choice of the producer, be determined in accordance with one of the methods set out in Schedule IX.

VERIFICATION PROCEDURES

a) Review the calculations prepared by the company including any supporting documentation, and interview company personnel for the purposes of identifying how the value of materials was calculated. Identify assumptions made by the exporter,
all cost types included in the calculations, allocation procedures, and the accounts from which the information was extracted. How are price and usage variances accounted for?

b) Determine if the value of materials reported by the company in the RVC information and the BOM is reasonable. Are direct material costs allocated in accordance with Schedule VII of the Regulations?

c) Assess the internal controls in place to preserve the quality and accuracy of the data available by reviewing policy and procedures manuals with respect to the purchase of materials, internal auditor's reports, setting of standards and identification of variances and by performing a walk through of the purchasing and receiving function and documenting the flow of information by tracing material requisitioning, ordering, receiving and reporting, returns, accounting, and cash disbursement.

d) Determine whether there are any related suppliers by:

i) reviewing company documents, i.e. vendor listing, annual report, organizational charts, and inquire of company officials;
ii) determine whether this relationship influenced the cost of materials purchased by examining purchase contracts, invoices or other documentation and by inquiring of company officials; if possible compare the exporter's purchase price with the related company to the price paid to unrelated companies.
iii) if it is determined that the relationship has influenced the price, then the Transaction Value is unacceptable. One of the alternate methods of valuation must be used i.e. Transaction Value of Identical or Similar materials or the Deductive, computed or residual methods. (You may want to use the "test values" as set out in Schedule VIII Subsections 3(4) to 3(7) to ensure that the Transaction Value is acceptable in instances where there are materials bought between related parties.)

e) Determine if any of the following occurred, making the Transaction Value of the material unacceptable: restrictions on the disposition or use of the material by the producer other than those imposed by law; that limit the geographical area where the material may be used; or that does not substantially affect the value of the material.

f) Identify if there is any waste and spoilage from the use of non-originating materials by doing the following:
- Inquire of company officials
- Obtain from the 2. PLANT TOUR verification sub-program indications of waste and spoilage.
- Inquire if there is any value for reusable scrap or by-products and ensure that they are deducted from the cost (you may want to scan the general ledger to see if any of these accounts exist and to what they relate to)
- Analyze the material price/usage variances and if these are a result of production waste and spoilage and assess the impact on the reported value of materials.
- Ensure the allocation of waste and spoilage to originating and non-originating materials is reasonable.

g) Identify and examine any assists.
- review purchase contracts, supplier correspondence files
- inquire of company officials

h) Select a sample of both originating and non-originating materials from the RVC information (or BOM) and document the selection criteria ensuring that high value parts are included in the sample. Coordinate with the work done in 4. ORIGINATING AND NON-ORIGINATING MATERIALS verification sub-program where there are confirmations and sample work done on invoices.
- trace to a sample of purchase contracts and invoices to determine the actual price paid by the exporter /producer trace to canceled checks; and debit/credit notes. For originating and non-originating imported materials, select a sample of materials to trace to Customs importation documents. Compare the value on these documents to the value identified in the RVC information and purchase invoices. Document the basis on which these materials were valued (i.e. Customs Value, Transaction Value (per Schedule VIII etc.) and any concerns.
- calculate the difference
between the actual and standard cost and compare with the price variance or variance from standard claimed by the exporter/producer; follow-up on any substantial differences;
- trace the total invoice amount to the appropriate ledgers and sub-ledgers to verify that purchases have been recorded correctly in the exporter's/producer's books and records;
- determine that costs incurred in transporting the material to the location of the producer have been identified and correctly reported (freight, insurance, packing, etc.). If these costs are accounted separately (i.e. not recorded on the invoice for the material purchase), you will have to trace these costs to the books and records and ensure that they are properly allocated to the material;

- determine that duty, taxes, and brokerage fees with respect to the purchase and importing of materials have been identified and correctly reported, making adjustments as required and identify whether the company actively takes part in a duty drawback program - if so, has the duty drawback refund been netted against the duty claimed above (examine supporting documentation for these costs). Determine the existence of in-house customs clerks and verify the correct allocation to the value of the materials of the salaries of these clerks, especially in the case of non-originating materials.
NOTE: While doing h), you should look for indications of improper sourcing, or fungible materials.

i) Ensure that all verification adjustments required for materials as a result of value of materials verification procedures have been recorded.

j) Conclude as to whether the value of materials is correct and consistent throughout the verification period.

6. INTERMEDIATE MATERIALS

VERIFICATION SUB-OBJECTIVE

The objective of this section of the verification program is to review any self-produced materials including self-produced packaging materials and containers, self-produced accessories, spare parts and tools, designated as an intermediate material by the producer. If intermediate materials are designated by the company, and are found to qualify, 100% of that value is considered as an originating material for RVC calculation purposes.

NOTE: For purposes of calculating the RVC of the good, the producer of the good may designate as an intermediate material any self-produced material that is used in the production of the good, provided that where an intermediate material is subject to a RVC requirement no other self-produced material that is subject to a RVC requirement and is incorporated into that designated self-produced material is also designated by the producer as an intermediate material. Also intermediate materials are goods in their own right and therefore the rule of origin applicable to an intermediate material.

VERIFICATION PROCEDURES

a) Inquire of the company officials as to how the value of the intermediate material was calculated.

b) Ensure that material, labor, overhead costs etc. related to the Intermediate Material are not double counted in the respective costs related to the final good.

c) Ensure that the verification procedures have been completed with respect to:
- verifying the tariff classification of the intermediate materials;
- determining the correct rule of origin;
- ensuring that the non-originating materials used in the production of the intermediate material have undergone the required tariff classification change. Refer to the B. TARIFF CLASSIFICATION verification program.

d) If the rule of origin contains a RVC requirement perform a RVC test based on the net cost method. Refer to the D. NET COST METHOD verification program for determining RVC using the net cost content calculation.
e) If more than one intermediate material has been identified, ensure that, where the intermediate material is subject to a regional value-content requirement, no other self-produced material subject to a regional value content requirement is used in the production of that intermediate material.

f) Conclude as to whether the Intermediate material is an originating material.

g) If an intermediate material is determined to be originating, calculate the total cost in accordance with subsection 7(6) and subsections 2(6) through 2(9) of the NAFTA Rules Origin Regulations. Refer to 7. NET COST CALCULATION verification sub-program of the intermediate material and carry forward that value, as an originating cost, to the net cost of the good.

7. NET COST CALCULATION

VERIFICATION SUB-OBJECTIVE

To ensure that the net cost has been determined correctly by using only eligible costs and reasonable cost allocation methods (where needed). The components needed in order to calculate the net cost are the total cost and the excluded costs.

Total costs

The total cost of a good consists of all product costs, period costs and other costs, incurred in the territory of one or more of the NAFTA countries, that are recorded on the books of the producer, without regard to the location of the persons to whom payments with respect to those costs are made. But total costs do not include the following:

- profits that are earned by the producer of the good, regardless of whether they are retained or paid out to other persons as dividends, or taxes paid on those profits, including capital gains taxes;

- gains related to currency conversion that are related to the production of the good;
(See subsection 6(12) of the NAFTA Rules of Origin Regulations)

- costs of a service provided by a producer of a good to another person where the service is not related to the good;

- gains and losses resulting from the disposition of a discontinued operation;

- costs relating to the cumulative effect of accounting changes reported in accordance with a specific requirement of the applicable Generally Accepted Accounting Principles;

- gains or losses resulting from the sale of a capital asset of the producer;
(See Schedule VII of the NAFTA Rules of Origin Regulations)

Note: The value of materials with respect to which production is accumulated, shall be determined in accordance with section 14 of the NAFTA Rules of Origin Regulations (Refer to 12. ACCUMULATION verification sub-program).

Total costs

a) Reconcile costs, submitted in the RVC information to the records (general ledger, etc.) of the company.

b) Ensure by scanning the detail in support of the total cost, the period costs, product costs, and other costs incurred in the territory of one or more of the Parties are included in the total cost figure. And ensure that the total costs do not include profits, corporate or personal taxes on income, dividends, or other accounts that should be classified as assets or reductions to income accounts, gains related to currency conversion, service costs not related to the good, gains or losses related to a discontinued operation, costs related to accounting changes, and gains or losses resulting from the sale of a capital asset.

c) Evaluate the method(s) used to allocate labor and overhead costs to the product under review and assess whether the methods used are consistent with the recommendations in Schedule VII of the Uniform Regulations.

Were allocation methods applied throughout the fiscal year?

For purposes of calculating the net cost, the excluded costs:

- shall be the excluded costs that are recorded on the books of the producer of the good;

- that are included in the value of a material that is used in the production of the good shall not be subtracted from or otherwise excluded from the total cost; and

- do not include any amount paid for research and development services performed in the territory of a NAFTA country (i.e. royalties are excluded costs, but research and development performed in the Territory is to be included in the total cost calculation).
(See subsection 6(13) of the NAFTA Rules of Origin Regulations)

The excluded costs are: **sales promotion, marketing and after-sales service costs; royalties; shipping and packing costs; and non-allowable interest costs**.

The verification objective for this part of the program is to verify that the expenses pertaining to sales promotion, marketing, and after-sales service costs, royalties, shipping and packing costs and non-allowable interest costs have all been considered as excluded costs for the purpose of the calculation of the Net Cost.

The following is the definition of **sales promotion, marketing, and after-sales service costs** as defined in the NAFTA Rules of Origin Regulations:

(a) sales and marketing promotion; media advertising; advertising and market research; promotional and demonstration materials, exhibits; sales conferences, trade shows and conventions; banners; marketing displays; free samples; sales, marketing and after-sales service literature(product brochures, catalogues, technical literature, price lists, service manuals, sales aid information); establishment and protection of logos
and trademarks; sponsorships; wholesale and retail restocking charges; entertainment;
(b) sales and marketing incentives; consumer, retailer or wholesaler rebates; merchandise incentives;

7. NET COST CALCULATION CONTINUED;

(c) salaries and wages, sales commissions, bonuses, benefits(for example, medical, insurance, pension), traveling and living expenses, membership and professional fees, for sales promotion, marketing and after-sales service personnel;

(d) recruiting and training of sales promotion, marketing and after-sales service personnel, and after-sales training of customers' employees, where such costs are identified separately for sales promotion, marketing and after-sales service of goods on the financial statements or cost accounts of the producer;

(e) product liability insurance;

(f) office supplies for sales promotion, marketing and after-sales service of goods, where such costs are identified separately for sales promotion, marketing and after-sales service of goods on the financial statements or cost accounts of the producer;

(g) telephone, mail and other communications, where such costs are identified separately for sales promotion, marketing and after-sales service of goods on the financial statements or cost accounts of the producer;

(h) rent and depreciation of sales promotion, marketing and after-sales service offices and distribution centers;

(i) property insurance premiums, taxes, cost of utilities, and repair and maintenance of sales promotion, marketing and after-sales service offices and distribution centers, where such costs are identified separately for sales promotion, marketing and after-sales service of goods on the financial statements or cost accounts of the producer; and

(j) payments by the producer to other persons for warranty repairs.

7. NET COST CALCULATION CONTINUED;

Excluded costs--royalties;

The following is the definition of **royalties** as defined in Section 2 of
the NAFTA Rules of Origin Regulations:

Royalties means payments of any kind, including payments under technical assistance agreements or similar agreements, made as consideration for the use of, or right to use, any copyright, literary, artistic, or scientific work, patent, trade-mark, design, model, plan, secret formula or process, excluding those payments under technical assistance agreements or similar agreements that can be related to specific services such as:

a) Personnel training, without regard to where performed; and

b) If performed in the territory of one or more of the Parties, engineering, tooling, die-setting, software design and similar computer services, or other services.

Excluded costs--shipping and packing costs

The following is the definition of **shipping and packing costs** as defined in Section 2 of the NAFTA Rules of Origin Regulations:

Shipping and packing costs means those costs incurred in packing a good for shipment and shipping the good from the point of direct shipment to the buyer, excluding costs of preparing and packaging the good for retail sale.

Excluded costs--non-allowable interest costs

The following is the definition of **non-allowable interest costs** as defined
in Section 2 of the NAFTA Rules of Origin Regulations:

Non-allowable interest costs means interest costs incurred by a producer on the producer's debt obligations that are more than 700 basis points above the yield on debt obligations of comparable maturities issued by the federal government of the country in which the producer is located.

The methods for calculating **non-allowable interest costs** are set out in Schedule XI of the NAFTA Rules of Origin Regulations.

Excluded costs

VERIFICATION PROCEDURES

The following verification procedures are recommended to verify that a proper dollar amount has been deducted from total costs for sales promotion, marketing, and after sales service costs; royalties; shipping and packing costs; and non-allowable interest costs. The emphasis on verification testing should be to ensure that these costs have not been understated by the company and have been properly allocated to the good under review.
a. Trace the detail of the net cost reported in the RVC calculation to the company's working schedule. Trace in turn these working schedules to the books and records.

b. Interview company personnel to understand how these costs are accounted for in the company's books and records. Review the above definitions with company personnel to ensure that they understand what costs are involved and to document rationale where little or no cost has been accounted for a particular item provided for in the definition (this is to ensure that there are no such costs in other accounts).

c. Obtain copies of agreements related to sales promotions and marketing. Review the terms of the agreements and ensure that they were properly accounted for in the net cost calculation.

d. Obtain copies of contracts related to shipping costs. Review the terms of the contracts and ensure they were properly accounted for in the net cost calculation.

e. Obtain copies of royalty agreements, technical assistance agreements, and other similar documents. Review the terms of the agreements and ensure that they were properly taken into account in the net cost calculation. (Remember that research and development performed in the Territory of a NAFTA country are includable costs)

f. Obtain copies of loan agreements. Review the terms of these agreements, particularly the interest rates charged, relate them to the products under review and identify loans by type (i.e. fixed or variable rate). Confirm payments have been made in accordance with the terms of the loan agreement. Ensure that any non-allowable interest costs have been properly taken into account in the net cost calculation (refer to Schedule XI of the NAFTA Rules of Origin Regulations).

g. Refer to the 9. PACKING MATERIALS AND CONTAINERS FOR SHIPMENT verification sub-program to identify any materials that should be included in the net cost of calculation.

h. Review the chart of accounts and the company's trial balance to identify those accounts which fall within the above definitions and conduct the following tests:

- select a sample of costs and trace to supporting commercial documentation, paying particular attention to journal voucher type entries; and
- where costs have been allocated for these costs, ensure that the method of allocation is consistent with that recommended in Schedule VII of the NAFTA Rules of Origin Regulations; and
-where it is determined that these costs should not be included in the net cost, ensure the reveal is only for the amount originally allocated.

i. Review the chart of accounts and the company's trial balance to identify accounts which appear to be included costs but that the company has ignored in the Net cost calculation. List these accounts for further testing to supporting documentation and discussion with company personnel.

j. Prepare a working paper to adjust the net costs figure on the submission of RVC information for any excluded or not allowable costs are deducted by the producer.

k. Conclude on the verification sub-objective.

8. PACKAGING MATERIALS AND CONTAINERS FOR RETAIL SALE

VERIFICATION SUB-OBJECTIVE:

The objective of this section of the verification program is to ensure that packaging materials and containers in which a good is packaged for retail sale, classified under the HTS with the good that is packaged therein, are taken into consideration when determining the RVC, but disregarded when determining whether all the non-originating materials used in production of the good undergo the applicable change in tariff classification.

VERIFICATION PROCEDURES

a) Identify materials considered to be packaging materials (i.e. decorative boxes for retail sale) by interviewing the company personnel and by reviewing the bill of materials.

b) Do not include these materials in the procedures set out in B. TARIFF CLASSIFICATION verification sub-program.

c) In the 4. ORIGINATING AND NON-ORIGINATING MATERIALS verification sub-program determine the origin of these materials.

d) Determine the value of these packaging materials:

i) where the packaging materials are acquired by the producer of the good from another person, refer to 5. VALUE OF MATERIALS verification sub-program; or
ii) where the packaging materials are produced by the producer of the good, at the choice of the producer;

- the total cost incurred with respect to all goods produced by the producer of the good, calculated on the basis of the costs that are recorded on the books of the producer, that can be reasonably allocated to those packaging materials and containers in accordance with Schedule VII; or
- the aggregate of each cost calculated on the basis of the costs that are recorded on the books of the producer, that forms part of the total cost incurred with respect to those packaging materials and containers that can be reasonably allocated to those packaging materials in accordance with Schedule VII. (Refer to the 7. NET COST CALCULATION verification sub-program.

9. PACKING MATERIALS AND CONTAINERS FOR SHIPMENT

VERIFICATION SUB-OBJECTIVE:

The objective of this section of the verification program is to identify packing materials and containers in which the good is packed in order to ensure that they are disregarded when calculating the RVC of the good as well as when determining whether the non-originating materials used in the production of the good undergo the applicable change in tariff classification.

a) Identify materials considered to be packing materials and containers for shipment purposes by:

- interviewing company personnel; and
- reviewing the bill of materials.

b) Ensure that the value for packing materials (i.e. the costs that are recorded on the books and records of the producer) is not included in the B. TARIFF CLASSIFICATION verification program as well as the 4. ORIGINATING ANDNON-ORIGINATING MATERIALS, 5. VALUE OF MATERIALS, AND 7. NET COST CALCULATION verification sub-programs.

10. ACCESSORIES, SPARE PARTS AND TOOLS

VERIFICATION SUB-OBJECTIVE:

The objective of this section of the verification program is to ensure that accessories, spare parts and tools delivered with the good are taken into consideration when determining the RVC of the good, but disregarded when determining whether all the non-originating materials used in the production of the good undergo the applicable change in tariff classification.
Done W/P
by Ref
a) Identify materials considered to be accessories, spare parts and tools by interviewing company personnel, reviewing the bill of materials, reviewing the owner's manual and by reviewing sales contracts.

b) Exclude these materials in the procedures set out in B. TARIFF CLASSIFICATION verification program.

c) Include the materials in the work done in the 4. ORIGINATING AND NON-ORIGINATING MATERIALS and 5. VALUE OF MATERIALS verification sub-programs.

11. INVENTORY MANAGEMENT SYSTEM

VERIFICATION SUB-OBJECTIVE:

The objective of this section of the verification program is to determine if an acceptable inventory management system is in place for fungible materials and/or goods that are commingled as well as for physically segregated originating and non-originating materials used in the production of the good and to identify the origin of goods of a specific shipment. If an acceptable inventory management system does not exist, all the fungible materials must be considered non-originating for the purposes of the RVC calculation. **NOTE:** The existence of fungible materials does not automatically require that this section of the program be used, as the exporter/producer may wish to treat the fungible material as non-originating or withdraw the certificate of origin for the good into which the fungible material is incorporated or used.

VERIFICATION PROCEDURES

a) Using the information from the 4. ORIGINATING AND NON-ORIGINATING MATERIALS verification sub-program obtain a listing of identified fungible materials.

b) If the material is dual sourced and commingled, determine the impact on the origin of the good should no inventory management system exist - that is if the material is determined to be non-originating, evaluate the impact in terms of the tariff classification change requirement (consider the use of the de minimis provision) by reviewing the information obtained in the B. TARIFF CLASSIFICATION verification program as well as in terms of the RVC requirement by reviewing the information obtained in the 5. VALUE OF MATERIALS and 13. CALCULATION OF THE RVC PERCENTAGE verification sub-programs. If the impact is significant, proceed with the evaluation of the Inventory management System.

c) If originating and non-originating fungible materials (goods) exist, determine if the company

used one of the following inventory management systems outlined in the NAFTA Uniform Regulations - Schedule X to determine the materials originating status:
Specific Identification
FIFO
LIFO
Average Method

d) Document the inventory management system from beginning to end, i.e., purchasing, receiving, storage of materials, removal from storage into production of goods, storage of goods and removal of goods from storage for shipment of goods.

e) If Specific Identification was used, ensure that originating and non-originating fungible materials (goods) were physically segregated, or ensure the existence of an origin identifier, and that inventory management records are available to substantiate that originating materials (or goods) were in fact tracked.

f) If FIFO was used, review the company's receipts and withdrawals from the inventory record system. Ensure that the origin of fungible materials (goods) **first received** was considered to be the origin of fungible materials (goods) first withdrawn.

g) If LIFO was used, review the company's receipts and withdrawals from the inventory record system. Ensure that the origin of fungible materials (goods) **last received** was considered to be the origin of fungible materials (goods) first withdrawn.

h) If the average method was used, ensure that the company applied the correct materials averaging ratio provisions (in the case of fungible goods, the ratio is applied to each shipment)

i) Ensure that whichever method was chosen, including the averaging period in the case of the averaging method, it was used from the time it was chosen to the end of the fiscal year. Has the system changed since the inception of NAFTA?

j) Determine that the company correctly identified the origin and/or supplier of materials (goods) in its opening inventory by:

-Identifying, in the books of the producer, the latest receipts of fungible materials (goods) that add up to the amount of fungible materials (goods) in opening inventory at the time an inventory method is chosen. Determine the origin and/or supplier of
materials (goods) that make up those receipts. Determine the origin of those fungible materials (goods) to be the origin of the fungible materials (goods) in opening inventory.

k) Review the inventory management system by performing compliance tests of a sample of purchase transactions. The sample should include transactions involving materials (goods) that were fungible materials (goods) at the inception of NAFTA and materials (goods) that were identified as fungible since the inception (i.e. change in supplier).

l) Is the inventory management system tested periodically? Obtain a description of periodic testing and evaluate its effectiveness.

m) Test a sample of fungible material (goods) inventories by identifying the origin of opening inventory, adding receipts /adjustments of materials (goods) and deducting withdrawals/adjustments and compare your result to the company's records (can test a variety of periods, materials and production processes).

n) Conclude on whether the exporter /producer has an acceptable inventory management system (refer to Schedule X of the Uniform Regulations) and how these materials (goods) should be accounted for in the determination of origin of the good subject to verification.

o) Conclude on the need for an inventory management system and on whether:

1. the inventory management system used by the company meets all the requirements of Schedule X of the NAFTA Rules of Origin Regulations; or

2. the inventory management system used by the company requires improvement to meet the requirements of Schedule X of the NAFTA Rules of Origin Regulations
- document the impact on the origin of the good under review.
-document the weaknesses of the system; or

3. the inventory management system does not meet the requirements of Schedule X and the company can/cannot construct the
necessary inventory management system - document the impact on the good under review.

12. ACCUMULATION

VERIFICATION SUB-OBJECTIVE

To ensure that the exporter/producer that chose to accumulate the production of one (or more) of his suppliers did so in accordance with Section 14 of the NAFTA Rules of Origin Regulations.

General

For purposes of determining whether a good is an originating good, an exporter or producer of a good may choose to accumulate the production of one or more producers, in the territory of one or more of the NAFTA countries, of materials that are incorporated into that good so that the production of the materials shall be considered to have been performed by that exporter or producer, provided that:

- all non-originating materials used in the production of the good undergo an applicable tariff classification change, and the good satisfies any applicable RVC requirement, entirely in the territory of one or more of the Parties; and

- the good satisfies all other rules of origin requirements.

Requirements:

-In order to accumulate the production of a material,

i) where the good is subject to an RVC requirement, the producer of the good must have a certification as described above that is signed by the producer of the material, and

ii) where an applicable change in tariff classification is applied to determine whether the good is an originating good, the producer of the good must have a statement signed by the producer of the material that states the tariff classification of all non-originating materials used by that producer in the production of that material and that the production of the material took place entirely in the territory of one or more of the NAFTA countries;

- a producer of a good who chooses to accumulate is not required to accumulate the production of all materials that are incorporated into the good;

12. ACCUMULATION CONTINUED;

- any information contained in the certification that concerns the value of materials or costs shall be in the same currency as the currency of the country in which the person who provided the statement is located.

Statement needed
Non-averaging costs from accumulated production

Where a good is subject to a RVC requirement and an exporter or producer of the good has a statement signed by a producer of a material that is used in the production of the good that:

a) states the net cost incurred and the value of non-originating materials used by the producer of the material in the production of that material;

i) the net cost incurred by the producer of the good with respect to the material shall be the net cost incurred by the producer of the material plus, where not included in the net cost incurred by the producer of the material the costs referred to in Paragraphs 7(1)(c) through (e) of the NAFTA Rules of Origin Regulations (i.e. freight, insurance, packing, transport to location of producer, duties and taxes, customs brokerage fees); and

ii) the value of non-originating materials used by the producer of the good with respect to the material shall be the value of non-originating materials used by the producer of the material **or**

b) states any amount, other than an amount that includes any of the value of non-originating materials, that is part of the net cost incurred by the producer of the material in the production of that material,

i) the net cost incurred by the producer of the good with respect to the material shall be the value of the material determined in accordance with Subsection 7(1) of the NAFTA Rules of Origin Regulations (refer to 5. VALUE OF MATERIALS verification sub-program), and

ii) the value of non-originating materials used by the producer of the good with respect to the material shall be the value of the material, determined in accordance with Subsection 7(1), minus the amount stated in the statement.

12. ACCUMULATION CONTINUED;

Averaging of Costs from Accumulated Production

Where an exporter or producer of the good does not have a statement provided in (a) or (b) above, but does have a statement signed by a producer of a material that is used in the production of the good that:

c) states the sum of the net costs incurred and the sum of the values of non-originating material used by the producer of the material in the production of that material and identical materials or similar materials, or any combination thereof, produced in a single plant by the producer of the material over a month or any consecutive three, six or twelve month period that falls within the fiscal year of the producer of the good, divided by the number of units of material with respect to which the statement is made,

i) the net cost incurred by the producer of the good with respect to the material shall be the sum of the net costs incurred by the producer of the material with respect to that material and the identical materials or similar materials, divided by the number of units of materials, with respect to which the statement is made, plus, where not included in the net costs incurred by the producer of the material, the costs referred to in paragraphs 7(1)(c) through (e) of the NAFTA Rules of Origin Regulations, and

ii) the value of non-originating materials used by the producer of the good with respect to the material shall be the sum of the values of non-originating materials used by the producer of the material with respect to that material and the identical materials or similar materials divided by the number of units of materials with respect to which the statement is made; or

d) states any amount, other than an amount that includes any of the values of non-originating materials, that is part of the sum of the net costs incurred by the producer of the material in the production of that material and identical materials or similar materials, or any combination thereof, produced in a single plant by the producer of the material over a month or any consecutive three, six or twelve month period that falls within the fiscal year of the producer of the good, divided by the number of units of materials with respect to which the statement is made,

i) the net cost incurred by the producer of the good with respect to the materials shall be the value of the material, determined in accordance with subsection 7(1), (Refer to 5. VALUE OF MATERIALS verification sub-program) and

12. ACCUMULATION CONTINUED;

ii) the value of non-originating materials used by the producer of the good with respect to the material shall be the value of the material, determined in accordance with subsection 7(1), minus the amount stated in the statement.

VERIFICATION PROCEDURES

a) Determine that only the net cost method has been used to calculate the RVC requirement where the producer has chosen to use accumulation.

b) Review the information received from the producer, that has accumulated the production, to ensure that it is mathematically correct and ensure that it has been correctly included in the RVC calculation.

c) Evaluate the quality of the statements and ensure that they contain all of the required information as stated above. When accumulated costs are averaged ensure that the statement includes the periods referred to in subsection 14(3) and verify if it falls within the fiscal year of the producer of the good.

d) Ensure that the profit component of the material being accumulated is not included in the net cost information by examining the supplier information and by comparing the price paid by the producer to the cost information provided by the supplier.

e) Use the applicable verification procedures in the following to evaluate the information received: B. TARIFF CLASSIFICATION verification program, and 4. ORIGINATING AND NON-ORIGINATING MATERIALS, 5. VALUE OF MATERIALS, 6. INTERMEDIATE MATERIALS, 7. NET COST CALCULATION, and 11. INVENTORY MANAGEMENT SYSTEMS verification sub-programs.

NOTE: Consideration should be given to the use of supplier confirmations and visits to the supplier to verify the authenticity of the information reported to the exporter/producer.

13. CALCULATION OF THE REGIONAL VALUE CONTENT PERCENTAGE

The objective of this final stage of the verification program is to actually calculate the regional value content percentage.

a) Obtain the value of all materials to be included in the net cost of the good and the value of non-originating materials identified in the 5. VALUE OF MATERIALS verification sub-program.

b) Add to the value of all materials to be included in the net cost, the value of other costs from the 7. NET COST CALCULATION verification sub-program to arrive at the net cost of the good.

c) Subtract the value of all non-originating materials (including packaging, accessories, spare parts, tools) from the net cost of the good.

d) Divide the difference by the net cost of the good. and

e) Multiply the result by 100 and

f) Conclude as to whether the good satisfies the NAFTA RVC requirement.

VERIFICATION PROGRAM E TRANSSHIPMENT
VERIFICATION OBJECTIVE

TO VERIFY THAT THE ORIGINATING GOOD, BY REASON OF HAVING UNDERGONE PRODUCTION THAT SATISFIES THE REQUIREMENTS OF ARTICLE 401 OF THE NAFTA, (1) IS NOT WITHDRAWN FROM CUSTOM CONTROL OUTSIDE THE TERRITORIES OF THE NAFTA COUNTRIES; AND (2) DOES NOT UNDERGO FURTHER PRODUCTION OR ANY OTHER OPERATION OUTSIDE THE TERRITORIES OF THE PARTIES, OTHER THAN UNLOADING, RELOADING, OR ANY OTHER OPERATION NECESSARY TO PRESERVE IT IN GOOD CONDITION, SUCH AS INSPECTION, REMOVAL OF DUST THAT ACCUMULATES DURING SHIPMENT, VENTILATION, SPREADING OUT OR DRYING, CHILLING, REPLACING SALT, SULPHUR DIOXIDE OR OTHER AQUEOUS SOLUTIONS, REPLACING DAMAGED PACKING MATERIALS AND CONTAINERS AND REMOVAL OF UNITS OF THE GOOD THAT ARE SPOILED OR DAMAGED AND PRESENT A DANGER TO THE REMAINING UNITS OF THE GOOD, OR TO TRANSPORT THE GOOD TO THE TERRITORY OF THE PARTY.

Note: The transshipment rule does not apply to a good of any of HTS subheading numbers 8541.10 through 8541.60 and 8542.11 through 8542.80 where any further production or other operation that the good undergoes outside the territories of the NAFTA countries does not result in a change in the tariff classification of the good to a subheading outside subheading numbers 8541.10 through 8542.90.

VERIFICATION PROGRAM - TRANSSHIPMENT

VERIFICATION PROCEDURES

1. Obtain and review copies of the invoices, bills of lading or waybills for the goods subject to verification for a sample period. Document the shipping route and all points of shipment and transshipment prior to the importation of the goods. Determine if the goods have been conveyed directly from the exporter on a through bill of lading to a consignee. Consider the need to gather information from the importer.

VERIFICATION PROGRAM - TRANSSHIPMENT CONTINUED;

VERIFICATION PROCEDURES

2. If the goods have not been shipped directly on a through bill of lading, they may be transshipped to an intermediary country, provided that:

(a) the goods remain under Customs transit control in the intermediary country - obtain copies of customs control documents to substantiate this;

(b) the goods undergo no operations in the intermediary country other than unloading, reloading, or operations necessary to preserve the good in good condition such as inspection, removal of dust that accumulates during shipment, ventilation, spreading out or drying, chilling, replacing salt, sulphur dioxide or other aqueous solutions, replacing damaged packing materials and containers and removal of units of the good that are spoiled, or damaged and present a danger to the remaining units of the good or any operation necessary to transport the good to a NAFTA country.

(c) In order to substantiate (a) and (b) above request from the importer/exporter:
-Customs receipt and release documents, exporter/producer shipment/production records, serial numbers of the goods, serial numbers of containers holding the goods, temporary import and corresponding export documentation, research material explaining the Non-NAFTA customs operations and procedures.

3. Determine whether any of the goods shipped were not produced by the producer. Consider the potential for fungible goods. If fungible goods are found, refer to INVENTORY MANAGEMENT SYSTEM verification sub-programs within RVC programs. From the transshipment information requested in procedure 2 of this program consider requesting that the exporter /producer develop a working paper which shows a reconciliation of shipments of goods exported by the producer and imported into the territory of the other NAFTA Party taking into account their quantities and values.

4. Conclude against the verification objective for transshipment.

ANNEX 5

CANADA

5.1 <u>Verification Period</u>
The verification period under review, for verifications conducted by the Origin Audits Unit, is typically a combination of the period for which the response to the Questionnaire was prepared, and if a significant amount of time has elapsed, the current fiscal period. Therefore, the goods produced in this entire period would be the subject of the origin verification.

As such, the goods imported should be matched to the period in which the goods were produced. In those cases involving complex production processes or where there is a lapse of time between the production and the importation periods, appropriate measures would be taken to reasonably satisfy this requirement.

5.2 <u>Coverage</u>
The scope of verifications conducted by the Origin Audits Unit, wherever possible, includes all models of goods manufactured by that exporter/producer that are exported to Canada and certified as originating. This often results in the identification of representative models where a product line is comprised of several, sometimes hundreds of models.

<u>Representativeness</u>

Many of the companies reviewed by the Origin Audits Unit manufacture several, sometimes hundreds of models of the same basic product. Often, the models are very similar with only a few minor differences. For example, the primary difference between each model could be the color of the paint. The concept of representativeness has been developed by the Origin Audits Unit to reduce on-site verification time by reviewing representative models, rather than all models manufactured and exported to Canada and certified as originating. The concept of representativeness involves allowing the exporter/producer to complete one questionnaire for a specific model within a product line and have that model represent the remaining products in the product line. This releases the company from the administrative burden of completing a response for every model in a product line, and implies that the origin decision for the representative model will be the decision for the other models in that product line. In order for the Department to consider a model as representative for a complete product line, the sourcing of materials and the manufacturing process must be similar to all other models within that line. The onus is on the company to prove that the selected model should represent the rest of the product line and this should be done as early in the verification process as possible, preferably in the initial planning stages of the verification.

Should the results of the verification indicate that the models selected by the company are indeed representative of their respective lines and that these models qualify as originating in accordance with the NAFTA and the rules of origin contained therein, all models within those lines will be considered to qualify. Conversely, if the representative models do not satisfy the rules of origin, all models within these product lines will not qualify for a NAFTA preferential rate of duty.

5.3 Identification of Importers

An important function during the initial stages of a verification is the identification and notification of all known Canadian importers. The current policy followed by the Origin Audits Unit is that when a referral for a verification is received, all Canadian companies who have imported goods from that exporter/producer are identified and notified in writing that the goods are under review. Once the file has been assigned to a verification team, it is the responsibility of the verification team to identify and notify all new importers who have begun to import from the exporter/producer during the course of the verification.

5.4 Assessment / Liquidation Period

The assessment period for verifications, other than the auto industry, conducted by the Origin Audits Unit is based on the date the Canadian importers were first notified that the origin of goods imported from the exporter/producer is under review. The existing policy has been set by Senior Management in order to allow the Canadian importer, who has relied in good faith on a Certificate of Origin provided by the U.S. or Mexican exporter/producer, to prepare for the possibility of being assessed additional duties and taxes. Therefore, during the planning phase it is necessary to advise in writing all known importers that the goods are under review. With this in mind, the verification period for verifications conducted under the NAFTA will include the fiscal year of the exporter/producer during which the importer has been notified. The assessment period for the auto industry, where there is an election to average, will be based on the averaging period.

5.5 Recommended Verification Procedures

During the course of a verification, Revenue Canada also conducts procedures directed towards verifying the applicable tariff treatment in accordance with Annex 302.2 of the NAFTA. The verification program for tariff treatment is as follows: **VERIFICATION PROGRAM - TARIFF TREATMENT**

VERIFICATION OBJECTIVE:

TO ENSURE THAT THE ORIGINATING HAVE BEEN IMPORTED INTO CANADA USING THE CORRECT TARIFF TREATMENT AS SET OUT IN ANNEX 302.2 OF THE NAFTA AND TO ENSURE THAT NON-ORIGINATING GOODS ARE IMPORTED USING THE CORRECT NON-NAFTA TARIFF TREATMENT.

VERIFICATION PROCEDURES:

Originating Goods

1. Before doing the following steps, ensure that the good satisfies its applicable rule of origin (if not, go to step 6) and:
a) for U.S. goods ensure
i) all tariff classifications for Mexican materials have been determined;
ii) all materials of Mexican origin have been identified while verifying the source of materials;
iii) the value of Mexican materials has been determined while verifying the value of materials; and
iv) where there is subsequent processing in Mexico, the transaction value of the good upon entry into Mexico or the VFD of the goods when imported into Canada has been determined.

VERIFICATION PROGRAM - TARIFF TREATMENT (CONT)
b) for Mexican goods ensure
i) all tariff classifications for U.S. materials have been determined;
ii) all materials of US origin have been determined while verifying the source of materials;
iii) the value of U.S. materials has been determined while verifying the value of materials; and
iv) where there is subsequent processing in the U.S., the transaction value of the good upon entry into the U.S. or the VFD of the goods when imported into Canada has been determined.

VERIFICATION PROGRAM - TARIFF TREATMENT (CONT)
Originating goods (produced in the U.S.)

2. a) Re-evaluate the origin of the good using its specific rule of origin considering all operations performed in and materials (note: this includes materials produced through subcontract work) obtained from Mexico as if they were performed in or obtained from a non-NAFTA country (removing costs associated with subsequent processing);
and
b) If there is subsequent processing done in Mexico, determine the value and ensure that the subsequent processing:
i) has not increased the TV of the good by greater than 7%, calculated as:
(TV of goods after processing in Mexico, less the TV of goods prior to processing in Mexico)
divided by
TV of goods prior to processing in Mexico, the quotient to be multiplied by 100, or
ii) does not have a value which exceeds 6.5421% of the VFD of the goods when they are imported into Canada, calculated as:
the value of processing in Mexico divided by the VFD of goods imported into Canada, the quotient to be multiplied by 100.

3. Based on the calculations performed in step 2, if
a) the good is still originating and there is no subsequent processing in Mexico then USTT applies;
b) the good is still originating and the subsequent processing in Mexico is under the limit then USTT applies;
c) if the good is still originating and the subsequent processing in Mexico is above the limit
i) determine if MT applies following the steps for originating goods in Mexico, if not
ii) MUST applies;
d) the good is non-originating and there is no subsequent processing in Mexico then MUST applies;
e) the good is non-originating and subsequent processing in Mexico is under the limit then MUST applies;
f) the good is non-originating and subsequent processing in Mexico is above the limit
i) determine if MT applies following the steps for originating goods in Mexico, if not

ii) MUST applies.

Originating goods (produced in Mexico)

4 a) For those goods produced in Mexico that meet the NAFTA rules of origin, re-evaluate the origin of the good using its specific rule of origin considering all operations performed on and materials obtained from the U.S.(note: this includes materials produced through subcontract work) as if they were performed in or obtained from a non-NAFTA country (removing any costs associated with subsequent processing), and
b) if there is subsequent processing done in the U.S. determine the value and ensure that the subsequent processing:

(i) has not increased the TV of the good by more than 7% calculated as:
(TV of the goods after processing in the U.S., less TV of the goods prior to processing in the U.S.) divided by the TV of the goods prior to processing in the U.S.,the quotient to be multiplied by 100.
(ii) does not have a value which exceeds 6.5421% of the VFD of the goods when they are imported into Canada, calculated as:
value of processing in U.S. divided by VFD of goods imported into Canada, the quotient to be multiplied by 100.

5. Based on the calculation performed in step 4, if
a) there is no subsequent processing in the U.S., then MT applies;
b) the subsequent processing in the US, is under the limit then MT applies;
c) the subsequent processing in the U.S., is above the limit
i) determine if USTT applies following the steps for originating goods in the U.S., if not
ii) MUST applies;
d) step 4(a) does not apply and there is no subsequent processing in the U.S., then MUST applies;
e) step 4(a) does not apply and subsequent processing in the U.S., is under the limit then MUST applies;
f) step 4(a) does not apply and subsequent processing in the U.S., is above the limit
i) determine if USTT applies following the steps for originating goods in the U.S., if not
ii) MUST applies.

Non-Originating Goods

The following steps should be done only when a good does not qualify as an originating good under the NAFTA rules of origin.

Non-originating goods exported from the United States

6. For non-originating goods exported from the United States, the Most-Favored-Nation tariff treatment (MFN) is the appropriate tariff treatment. No further verification steps are required because it is the highest rate of duty that can be paid on these goods.

Non-originating goods exported from Mexico

7. For goods entitled only to the GPT, ensure that the GPT conditions have been met (refer to step 9 for the conditions)

8. For goods entitled only to the MFN, no further verification work is required.

9. For non-originating goods exported from Mexico that are entitled to both the MFN or the GPT tariff treatments, choose the lower of the two. If GPT is the tariff chosen, the importer holds the

responsibility to substantiate the claim for the GPT treatment. The importer requires proof of origin and a through bill of lading. Proof of origin can be either the Certificate of Origin Form A or a statement contained on the commercial invoice or CCI or separately, and must state the percentage of the ex-factory price which originates in GPT countries (> 60%). Consult the D-Memo for the verification of the GPT tariff treatment.

NOTE: If the goods are agricultural, textile and apparel goods, there are special provisions for these goods which are explained in Memorandum D11-4-19.

10. Conclude on the verification objective.

ANNEX 5 MEXICO

5.1 Verification Period

The verification period under review, for verifications conducted by the Direction of International Audit (DIA), is the period in which the goods imported into Mexico were actually produced. The scope of the verification will be indicated by DIA in the origin verification questionnaire or in the intent to conduct a verification visit notification.

For this period, the goods imported should be matched to the period in which the goods were produced. In those cases involving complex production processes or where there is a time lapse between the production and the importation periods, appropriate methods would be taken to reasonably satisfy this requirement.

5.2 Coverage

The scope of verifications conducted by the DIA, wherever possible, includes all models of goods manufactured by that exporter/producer that are exported to Mexico and certified as originating.

5.3 Identification of Importers

An important function during the initial stages of a verification is the identification and notification of all known importers. The current policy followed by the DIA is that when a referral for a verification is received, all known importers who have imported goods from the exporter or producer are requested to provide a copy of the certificate of origin issued by the exporter and/or producer of the imported goods, and copies of all documents related to the importation. Once the information is analyzed, the file is assigned to a verification team.

5.4Assessment/Liquidation period.

The assessment period for verifications conducted by DIA commences on the date of importation into Mexico and finalizes on the date in which the duties and taxes owed are paid.