



Agile, adaptable global supply chains need to incorporate international trade compliance

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Introduction

Well-intended articles on supply chain management routinely discuss ways in which companies with global procurement strategies can build agile, adaptable and resilient supply chains that can withstand disruptions with minimal economic impact. It should come as no surprise to anyone, then, that when two international trade attorneys are asked for their opinion on the subject, they would write an article discussing how regulatory compliance is a key factor in an efficient supply chain and why a compliance program for managing risk and ensuring compliant customs and export controls transactions should be at the top of every supply chain manager's "to-do" list. While we do believe that most companies genuinely want to comply and do the right thing, we are not naïve enough to believe that the necessary resources are always available to place trade compliance at the top of all global traders' priority lists.

We offer the following to entice you to read further: the American Association of Port Authorities reported that in 2008 there were approximately 435.7 million TEUs that moved through the top 125 ports around the world¹; the Bureau of Economic Analysis reported imports of \$456.9 billion and exports of \$305.7 billion in the first quarter of 2010.² As lawyers, we know that any time there is a slow down or a delay in the supply chain, our clients lose time and money. From our perspective, most compliance-related delays are triggered by an information exchange of some sort between a link in the supply chain and a government agency. This article provides a summary of what upper management can do to help build compliance into the supply chain and to plan for effective management when government agencies make inquiry or show up unexpectedly with a subpoena or search warrant.

“Regulatory compliance is a key factor in an efficient supply chain and compliance program for managing risk and ensuring compliant customs and export controls transactions should be at the top of every supply chain manager’s “to-do” list”

We hope after considering this article readers will be aware of how compliance gaps or deficiencies can cause supply chain disruption and will feel compelled to move the action item “establish a trade compliance program” from the “nice to have” list to the “must have” list.

Overview of regulatory compliance regimes

A. Where are information exchanges taking place?

The regulatory underpinning of international trade compliance typically is imposed by a variety of agencies or other governing bodies that issue the rules and requirements by which we conduct cross-border trade. While these agencies may or may not directly interface with international supply chains, their rules and requirements will be loosely organized under two over-arching and diverse regulatory structures.

1. Customs regimes

While not obvious to most importers, a nation's customs service is generally the agency most often involved in the import process. For those new to the world of importing, customs regimes typically

are responsible for determining whether goods are admissible in the first instance, assessing and collecting duties on imported goods, examining containers and goods for contraband (narcotics or other prohibited imports) and enforcing a myriad of diverse laws and requirements that fall under the purview of numerous other regulatory bodies.³ In many countries, the customs regime is housed in the government department responsible for taxation or for homeland security.

In terms of information exchanges, the import process in most countries requires that accurate information be transmitted to the customs regime by the importer or the importer's agent. Often, customs uses computer systems (sometimes sophisticated; sometimes not) to analyze the data it receives at the time of importation to make various determinations, including whether more information is required or whether physical inspection of the goods is warranted. Sending accurate and complete information to the relevant customs authorities, therefore, leads to fewer physical examinations and general inquiries. The computer systems used by customs sometimes disagree or make random decisions to conduct further scrutiny, however. It's like a customs slot machine - every customs declaration is like a coin inserted, and sooner or later the right combination will come up, and the goods will require physical inspection and/or the importer will be questioned or audited. In addition to transmitting accurate data, global traders need a strong compliance program so that they are well prepared to respond when, through the luck of the draw, their goods must be physically inspected or they must submit more information to the responsible regulator.

As noted, customs authorities often are housed in the same department or agency as the tax and revenue authorities. In some cases, the export controls authorities are also housed in the same place. While not universally the case, these different authorities often will share their findings on a particular company. As a result, a tax audit can lead to a customs audit or to an export controls investigation, and vice-versa.

Companies with international supply chains consisting of related or affiliated parties also may find their global approach to transfer pricing in the countries in which they transact business at odds under the separate and disparate laws of the tax and customs authorities. To optimize taxable income within national boundaries, tax authorities favour a low entered value for goods entering their country; however, to generate high import tariffs and fees, customs agencies favour a high entered value on the same goods. The so-called “whipsaw” effect of the competing national or regional tax and customs interests can cause internal strife within an organization, pitting tax and trade compliance personnel against one another.

To avoid being caught off guard and subject to harsh penalties and enforcement actions, global traders not only need a strong network of internal controls for all areas subject to government scrutiny, but also they need to establish across their international operations open channels of communication among the different functional areas of the company that impact cross-border movements so as to remain vigilant of the possibility of one government inquiry spawning others. In other words, companies need an adaptable, agile supply chain that can manage interruptions by government agencies checking for compliance.

2. Export control regimes

Every import was someone else's export. And in several countries, there are strong export control regimes in place to monitor and control

export activity. By control, we mean that the regime implements regulations designed to prevent military-type items and items that may have both a military and civilian use (ie, so-called “dual-use” items) from being delivered to individuals, companies or countries that are considered to be bad actors by the exporter’s home country. Often, a country’s export controls regime will have multiple agencies involved in different aspects. For example, in the United Kingdom, both HM Revenue and Customs and the Department for Business, Innovation and Skills have shared responsibilities for implementing export controls. In the United States, the Department of Commerce, Department of State and US Customs and Border Protection play various roles in regulating exports.

In terms of information exchanges, before they can ship their goods, exporters will often be required to submit license applications to the various regulating agencies for pre-approval. One major area of difference between customs rules and export controls, however, is in the treatment of intangibles. By international agreement, namely the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO), many countries do not consider intangible electronic transmissions to be transactions (or imports) that need to be declared to the customs regime. By contrast, however, as a matter of national sovereignty, many countries have stringent controls in place for outbound transfers of technology and technical data that can be used to create the specific items sought to be controlled. The information itself often is controlled for export.

That point bears repeating. **Information itself can be controlled for export**, whether it is sent via an electronic mail message as an attachment, downloaded from a web site, shown during an inspection or tour, or communicated orally by an engineer talking to a person in another country. Without a rigorous export compliance program in place that includes appropriate human and systems safeguards, global traders often find themselves subject to harsh penalties and fines, to public censure, and to loss of export privileges, or even criminal penalties and jail time.

B. What happens when a government authority is less than satisfied with information exchanges?

At the risk of stating the obvious, interaction between a company and government authorities often can be a slow and arduous process. Government agencies that regulate cross-border trade interact with so many different entities in the supply chain and are responsible for a multitude of diverse product lines. Further, these agencies must frequently apply vague or contradictory legal requirements, thereby impeding their ability to facilitate border crossings. At the same time, global traders often weigh down this process by not knowing or bothering to understand the myriad rules and requirements that govern the movement of goods across national boundaries.

Companies may need to make several attempts to communicate to customs and other authorities the exact information needed for these agencies to reach a decision or render a determination on whether goods can enter or leave a country without the need for further dialog. To minimize the frequency and scope of such needless or protracted delays, full and accurate information must be submitted to the relevant government regulators at the earliest opportunity. Government agencies often are dealing with so many different variables, however, that additional scrutiny or inquiry surrounding an actual or attempted cross-border movement ultimately may be inevitable. And while most customs authorities will fervently deny that they are motivated by economic considerations, many of their decisions can and do contribute to the financial well-being of their sovereignty (eg, tariff collections and anti-dumping assessments). For the global trader, the unfortunate counter-balance effect is decreasing or disappearing margins or profit levels.

On the export side, incorrect or inaccurate information often can lead to export license delays or outright denials, either of which can lead to very unhappy customers, as well as other entities comprising the supply chain.

International trade compliance programs

The informed and risk-averse global trader has a formal code of conduct policy that clearly states that the company and its various

affiliates will obey the laws of the jurisdictions in which they do business. We believe that even their smaller counterparts engaged in global procurement would not disagree with the importance of staying on the right side of the law. An initial benefit of having an adequate trade compliance program is the ability to operate in those countries or regions that are strategic to an organization’s business plan.

A. Why have one?

1. License to operate

Companies that are heavily dependent on their ability to continue importing or exporting to sell their goods or services must have as part of their overall compliance initiative an international trade compliance program (an ITCP). This function within an organization having a global supply chain is similar in nature to those programs that manage tax information and reporting, environmental health and safety programs, and anti-bribery (Foreign Corrupt Practices Act) programs.

While not nearly as well known or perhaps as engaging as other company initiatives, an ITCP can help keep a company’s supply chain running smoothly when importing and exporting is involved. An ITCP also has other benefits that can help return money to the company, including the ability to take advantage of duty-savings programs such as free trade agreements, free or foreign trade zones and duty-drawback (refund) programs.

Numerous countries also have established supply chain security programs, which are typically administered by their respective customs authorities. These programs offer special benefits to their members, such as reduced cargo inspections, expedited clearance and fewer compliance audits and related inquiries. Membership in these programs requires an ITCP. As numerous global traders will confirm, each of these programs can have a heavy compliance cost and significant penalties for making mistakes. Companies should not undertake any special program unless they can meet the rigors of the program.

2. Free trade does not mean easy trade.

Most countries that not only encourage but also promote cross-border trade offer global traders special duty elimination or reduction if they can satisfy the rigors of their programs. These programs are typically designed to promote trade (and the relationship) between two countries, to strengthen an economic or culturally diverse region or to fortify large trading blocs. To ensure that “outsiders” do not unintentionally benefit from these arrangements, state and national legislatures, as well as regulators, will impose qualifications that must be met to take advantage of program benefits. Looking across the extensive free-trade models that are most common today, these qualifications may consist of the need to satisfy a particular rule of origin, a tariff-shift requirement (non-originating materials must undergo a change in tariff classification), a local content (certain percentage of direct cost of processing must be attributed to qualifying country), or a combination of any one or more of these tests.

As these program requirements almost universally have legal underpinnings, they fall by default into an ITCP. While the compliance responsibility associated with free trade agreements can be heavy from a resource and operations standpoint (many of these programs have special documentary, certification and audit requirements), annual monetary savings can add substantially to a company’s bottom line. The flip side is that failure to heed the compliance responsibility can cost a company millions in penalties and fines, bring about diminished standing in the eyes of local regulators, and tarnish the company brand through negative publicity.

B. What are the elements of an effective ITCP?

Taking its cues from the serious ethical and financial reporting lapses that occurred in the United States close to a decade ago, US trade regulators identified various characteristics that have become iconic of an effective ITCP. They are:

- Control environment — this element pertains largely to the organizational structure, policies and procedures,

and assignment of responsibility for trade compliance. Organizations that have high focus on strategic collaboration across the company and on risk management generally locate responsibility for trade compliance under supply chain. Many organizations ensure executive awareness of the function by assigning ultimate responsibility for compliance at the Senior Vice President or Chief Compliance Officer level, with direct or in-direct oversight to the law department. Such programs also have a network of policies and procedures that are compliance driven and clearly espoused by upper management.

- Risk assessment — this covers tools and approaches used by the organization to identify, analyze and manage risk. The “rules of the road” for trade compliance often are subject to the whims of the national and global market place, and organizations must constantly assess how compliance considerations will impact the overall supply chain. The trade compliance function should, at minimum, have a solid understanding of the compliance regimes that may inhibit or impede the free movement of goods across national boundaries and, at the same time, add capabilities that will support the organization’s strategic projects.
- Control procedures — formal policies and procedures are the centerpiece of a compliance program and are meant to ensure management’s directives are carried out. These internal controls can take many forms and should spread across the organization. At minimum, however, they should be documented and made readily available to all company stakeholders who play a role in ensuring that import and export transactions are compliant (procurement, engineering, tax, finance, receiving, accounting, etc.). In addition, they may involve systems investments that allow an ITCP to “see around the corner” and to automate basic compliance activities and documentation.

- Information and communication — an ITCP should create a network of compliance stakeholders and ensure, either formally through organizational structures or informally through meetings or on the company intranet, that they are informed on customs requirements, cargo security, social compliance and responsibility, etc. By building proactive compliance requirements into each functional step in the supply chain, the organization will avoid or mitigate risk.
- Monitoring — an ITCP should have a process for assessing internal controls over a period of time. As noted above, trade compliance rests on an ever-shifting foundation. To ensure that the organization remains informed and proactive, an ITCP should align global compliance solutions with supply chain and financial IT systems. Further, an ITCP should periodically test import and export transactions and develop performance metrics that, in turn, flag when enhancements are needed.

Conclusion

A global trader’s supply chain is only as strong as its weakest link. If sourcing strategies, as well as operational processes and procedures, are not backed up by a strong ITCP, the supply chain can become kinked (and possibly crippled) by compliance-related risks. For this reason, senior company personnel responsible for seeking and exploiting open trade lanes to further their company’s business strategies would be well-advised to ensure that the risk management principles of an effective trade compliance program are not only in place, but also being followed. By doing so, they ensure (to the extent it is within their control) that the business enterprise has open and continuous access to its supply chain. ■

1. <http://www.aapa-ports.org/Industry/content.cfm?ItemNumber=900>

2. (FN1 See <http://www.bea.gov/newsreleases/international/transactions/transnewsrelease.htm>)

3. For example, in the United States, US Customs and Border Protection, which is within the US Department of Homeland Security, is responsible for enforcing the regulations and requirements of over 40 other agencies involved in international trade. These include, for example, the Departments of Agriculture, Commerce, Energy, and Transportation; the Consumer Product Safety Commission; the Environmental Protection Agency; the Federal Communications Commission; the Federal Trade Commission; the Food and Drug Administration; and the Nuclear Regulatory Commission.