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DEVELOPING AND MANAGING AN EFFECTIVE INTERNATIONAL TRADE COMPLIANCE PROGRAMME

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HOT TOPIC

DEVELOPING AND MANAGING AN EFFECTIVE INTERNATIONAL TRADE COMPLIANCE PROGRAMME



PANEL EXPERTS



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Michael Cone concentrates his practice in the areas of administrative, customs and international trade law. He counsels clients on a wide array of regulatory compliance issues, with administrative expertise that includes matters falling under the jurisdiction of US Customs and Border Protection (CBP) and the panoply of other administrative bodies that regulate the importation, exportation, marketing and sale of merchandise.



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Agnes Cruz is an international trade professional with 22 years international experience in customs compliance. She has worked in the telecoms industry for 16 years, the last nine of which as head of customs. Ms Cruz focuses on customs valuation and classification, country of origin, Incoterms, free trade agreements and customs compliance matters, involved in the global movement of goods among 120 countries.



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RC: Could you provide a general insight into the complex array of trade regulations with which companies engaged in global trade have to contend?

Cone: Multinationals face a daunting panoply of regulations in every country where they do business. Take the US. Aside from basic customs rules on classification, valuation and country of origin, Customs and Border Protection (CBP) helps enforce the regulations of over 40 other federal agencies possessing an interest in imported goods. For example, imported food, cosmetics and drugs must comply with regulatory requirements of the Food and Drug Administration, children's items are subject to safety standards promulgated by the Consumer Product Safety Commission and vehicle parts must comply with standards of the National Highway Traffic Safety Administration. For goods moving out of a country, export control regimes can be highly complex and often bifurcate strictly controlled 'things that go boom' with more easily traded silent merchandise. There are also anti-bribery regimes to fight corruption and sanctions regimes combating business with unsavoury characters, both of which have extraterritorial grasp. It is a complicated and risky landscape.

Smith: Complexity is driven by factors such as geography, political agendas, protectionism,

products, safety, security and communication, just to name a few. Fortunately, there are some consistencies in global trade that provide a degree of regulatory certainty, such as trading with a member nation of the World Trade Organisation (WTO), or the general consensus among developed nations involving anticorruption, although this is still evolving. Beyond that, products and services moving across borders are subject to a multitude of import and export regulations that are product specific. For instance, a food product may be subject to numerous regulations from multiple agencies such as customs, agriculture and food & drugs in both the country of export and their equivalents in the country of import. Remaining current with regulatory changes, interpreting both the spirit and letter of the requirements – often in multiple languages – and communicating these requirements effectively to an internal audience are some of the key challenges faced by today's global traders.

Neuschul: Trade regulations, and their impact, are a key driver for a business' planning, decision making and execution processes when entering a new market or when facing trade regulation changes in an existing one. To highlight the complexity of such regulation, let us just look at what goes on with one single transaction from the US. When the transaction is initiated, contracting involves applying Incoterms, performing anti-boycott and sanctions screening and export controls considerations – such as ECCN,

deemed exports, dual-use, government users, and so on. Upon export, filing and recordkeeping rules apply. Once the goods arrive at their destination, a customs declaration containing correct classification, country of origin, value and other information has to be filed, and in order to do that, we must have a registered importer of record, a customs broker and a trade compliance programme that will monitor and manage all these risks. Hence, viewed on this most basic level, one can see how complex the global trade-regulatory environment can be for a truly global company.

Cruz: The primary regulators in the field of customs are two intergovernmental organisations: the WTO and the World Customs Organisation (WCO). The implementation and interpretation of the legal instruments issued by these bodies vary depending on the area, region and country. Each country controls customs compliance based on national regulations. The WTO regulates multilateral trade issues including general duty levels, non-preferential country of origin, abolition of non-tariff barriers, trade dispute settlement and the ITA Information Technology Agreement. The WCO regulates multilateral customs issues including the harmonised tariff code and the valuation of goods for customs purposes. Free trade and duty agreements – such as EUR-MED, NAFTA or MERCOSUR – regulate bilateral

and internal duty levels between members, as well as preferential country of origin. There are also country-specific rules and regulations, national boards of

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*Michael Cone,
FisherBroyles*

customs of individual states and the International Chamber of Commerce (ICC) to consider.

RC: What are the main legal and regulatory developments to have impacted international trade over the past 12 months? What steps can companies take to monitor changes and update their compliance programmes?

Cruz: The recent economic situation has brought several bilateral agreement changes, some to an almost unreachable level of compliance criteria. Origin restrictions due to political reasons have also been a challenge. A vicious circle of economic

challenges has also made the component and manufacturing industries move their factories constantly or have multiple locations producing the same goods. It is critical to have control of your supply environment, since the most visible impact is usually a bottleneck at the moment of exporting and importing. Origin sourcing criteria can and should be implemented either via frequent training or regulation of procurement and product development organisations. It is also recommended to monitor supplier origin declarations and exert control over the end-to-end flow.

Neuschul: The main recent regulatory developments relating to international trade globally have been in the area of export controls. In addition to the US Export Control Reform initiative, which has recently seen many amendments to specific rules and regulations, there is a whole list of countries which are either initiating or upgrading their export control legislations. A company dealing with controlled products, technologies or software can be profoundly impacted by these reforms, and monitoring this impact is crucial. It is important to understand what 'controlled' means. Usually, it is a paramount task for any given company's trade compliance function to do this monitoring on its own on a global scale. Hence, it is advisable to have either appropriate involvement

with industry groups, which have bodies that monitor and inform their members, or have counsel that can keep the business well informed and helps with planning on how to address these changes.

Smith: In the US and Europe, it could be said that changes in their economic sanctions postures over the last year could have presented the biggest challenges for global traders. Additionally, there has been a pronounced uptick in more aggressive enforcement, specifically in the area

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*Agnes Cruz,
Nokia*

of anticorruption. Traders also have to plan for anticipated changes in the regulatory landscape resulting from the next generation of trade agreements that go beyond the traditional duty preference model and now include provisions for human rights and the environment. For companies with a complex supply chain, these changes can

take years to plan for and implement. Monitoring regulatory changes on a global scale and keeping a compliance programme up to date require both a solid network of external service providers and internal stakeholders, regionally and locally.

Cone: The past 12 months have been marked by substantial uncertainty. The TPP and TTIP now appear destined for the political graveyard but the impact of Brexit on trade flows and investment remains unclear. There has been increased enforcement on both sides of the Atlantic in the areas of export controls, anti-bribery, customs and banking regulations. A new trade and investment regime in Brazil, the *Trek Leather* court decision in the US which broadened the domain of companies and individuals potentially liable for customs violations, and new regimes for the enforcement of intellectual property and antidumping laws in the US, will impact many multinationals. Companies need to pay close attention to developments to ensure that revisions which affect their core areas of trade do not interrupt the movement of goods through their supply chain or disrupt their operations due to concomitant enforcement actions.

RC: Developments such as Brexit, the stalled TPP and TTIP, and the failed Doha round all point to a retraction from free trade by world populations and governments, and an increase in barriers

to trade. How will these trends impact multinational companies, and how can they adapt given the uncertain future of global free trade?

Neuschul: These developments not only present uncertainty in terms of global free trade, but can be crucial to a company's future in certain markets overall. Issues such as tax treatment, global expat positioning, capital liquidity and security and revenue/profit repatriation are all impacted. The global trade planning and compliance function plays only one part in this process, but it is a very important part. The reason it is usually important, among the more obvious things, is that it is on the operational forefront and can shed light on other crucial potential issues. As companies plan for these legislative and political movements, it is imperative that the resources that the company has for managing the global trade function have a seat at the big table where essential decisions about the company's future are made.

Cone: Recent global developments, including Brexit and the stalled global trade talks, reflect the growing suspicion on the part of populations in the industrialised countries that the free trade deals of the past have not worked to their benefit. Multinationals, who have benefited most from free trade deals, should consider revising supply



chain strategies to increase local content and local employment, while decreasing their energy and pollution footprint. Such adaptations may help shift public opinion in favour of multinationals' products. Increased use of local branding, rather than pursuit of worldwide branding, may also help shift local perceptions. By increasing production in G-7 countries and making it well known, multinationals can increase consumer mindshare among critical populations.

Cruz: It is uncertain whether the EU and the US, having driven a global trade liberalisation agenda in the past, will remain equally engaged in global trade policy in the future. Hence, the international trade regime of the WTO and its multilateral approach should be valued. Bilateral FTAs are good when global agreements fail; however, a grid of FTAs will not replace a global solution because of complex and more globalised supply chains.

RC: How important is it for companies to efficiently and strategically integrate import and export processes into their overall business plans and supply chain management procedures? What are some of the common challenges in achieving this goal?

Smith: A global trader that has not fully integrated its import/export strategy into its business plan

will not remain competitive. Many companies rely heavily on strategic global sourcing to maintain their competitive advantage. Margins can be significantly impacted by duty management, such as the use of free trade agreements. Supply chains can realise greater efficiencies and lower landed costs through the strategic use of free trade zones and trusted trader partnership programmes that can reduce dwell times thus increasing velocity. The challenge for most companies begins with hiring talent with a strategic perspective. Many companies start out with a domestic focus and later evolve internationally. The import/export functions in these companies tend to follow the same path, never fully developing the strategic expertise required for a successful global trader. Next, the challenge is to position that expertise organisationally so that it has a seat at the strategic planning table, so to speak.

Cone: Lean manufacturing requires real-time visibility into import streams. Where lean manufacturing is not matched with pending orders, reduced inventory costs are not achieved. Thus, manufacturing companies sourcing imports from abroad and exporting finished products face substantial challenges to maintain visibility into both the import and export streams of their operations, manage local and international freight, adjust to input shortages and cancelled purchase orders, and communicate effectively with all their business partners. Software plays a crucial role in

supply chain management, but companies must also establish effective internal controls so that internal divisions such as purchasing, warehousing, logistics and accounting keep each other apprised of key developments and contingencies. A common problem affecting multinationals is parental control over sourcing, invoicing and payments. Lack of local autonomy can result in higher costs for inputs and third-party services as well as a subsidiary whose management personnel feel disenfranchised.

Cruz: It is important to safeguard risk management, overall process compliance and seamless execution, using proper ERP systems that support regulatory updates on the implemented environment. Challenges start with understanding the importance and split of customs clearance procedures as part of the entire supply chain, bringing different legal aspects to be addressed beyond just cost efficiency. Related questions might include, "What is the business case to implement a risk mitigation action?" and "Does the investment pay off?" Furthermore, the question should be different when it comes to the legal impact on compliance, such as: "What could be the impact on our business if a non-compliant operation is performed systematically?"

Neuschul: I believe that most, if not all, successful supply chain management professionals understand the need for well functioning global import/export

processes. However, as we look at other areas of the business, which are impacted by export and import related legislation, such an understanding might not be so obvious. To illustrate, for example, a company developing certain technology or software might employ nationals of multiple countries, and have code and design repositories open to all or most employees. This so called 'deemed exports' area can be easily overlooked, as HR might not be the traditional collaborator of the global trade function, and violations can be significant. One way to address this effectively is to have the trade function empowered enough to have insight into areas outside of just the supply chain. Having trade as part of an operational yet central function, such as tax, is a way to provide that insight.

RC: In your opinion, how difficult is it for multinational companies to navigate the complex area of Free Trade Agreements (FTAs)? How should companies go about managing FTA requirements such as acquiring a sound understanding of rules of origin, for example?

Cruz: In the last five years, the number of FTAs has almost doubled, transforming opportunities into challenges for companies working in a global environment. Therefore, it is recommended that companies have access to a specialist in this area acting on it as a predominant task, or, depending on

the size of the operation, a dedicated organisation that can establish company-wide coverage and a good governance programme. Last but not least, companies should get support from professional tools, where all FTA-specific rules are updated by a single source.

Neuschul: For some companies, FTAs and other duty relief programmes have huge cost impacts. However, before a duty relief programme is implemented, we need to know with certainty how big such savings are, and present to management that these savings are material to the organisation and that the savings exceed the costs of administering such programmes – metrics, metrics and metrics. One good thing is that many new and existing FTAs are modelled after similar rules, hence making the origin determination and recordkeeping processes more streamlined across multiple FTAs. The compliance management for FTAs is more involved and requires a higher degree of diligence compared to other trade processes. Ultimately, duty relief programmes have to be approached with caution and the full understanding of both costs and benefits needs to exist before a programme is implemented. Having a good internal audit control measure that monitors compliance is money well spent.

Cone: FTAs present enormous trade advantages for scrupulous companies. Unfortunately, they contain a variety of pitfalls arising not only from excruciatingly complex rules of origin but also from gaps in specificity and interpretation that are often worked out only in adversarial proceedings with the importing company on the defensive. When disputes

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*Darko Neuschul,
Facebook Inc*

arise the stakes are always high as FTAs either eliminate or drastically reduce customs duties. The opportunity for significant duty savings means FTAs lend themselves to abuse and are considered high risk by customs authorities. Along with antidumping and countervailing duties, IP infringement and textiles and wearing apparel, CBP considers FTAs as a ‘Priority Trade Issue’ because they “represent high-risk areas that can cause significant revenue loss and harm the US economy”. Administrative and court actions frequently arise over FTA claims and

multinationals should consult with expert customs counsel prior to claiming FTA preferences.

Smith: FTAs can be very difficult to manage. Some companies with a narrow product mix or simple bill of materials can manage without too much difficulty, but others who manage numerous products with a complex bill of materials and origins require entire departments of experts who ensure the accuracy of their preferential claims. Confounding the process even further is the volume of FTAs on a global scale, each with their specific rules, and the process of qualifying a claim which requires clear communication and cooperation from the supplier base. To effectively manage an FTA programme, a focus must be applied to compliance with the terms of the agreement. Preferential duty claims are a perennial area for audits. Internal controls should be maintained, such as recordkeeping, training, auditing and the monitoring of programme changes, among others. Traders need to do a risk assessment and develop a sound business case for the use of FTAs.

RC: What are some of the penalties that companies might face if they are found to be in breach of international trade rules and regulations?

Cone: Companies fall into trouble for import violations, export violations, overseas bribery, doing business with an entity on the 'bad guy' sanctions list, and various other regulatory missteps. On the import side, CBP will seek to collect any customs duties it thinks went unpaid and then often attempt to penalise the importer for between two and

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Starbucks Coffee Company*

four times the unpaid duties as icing on the cake. Where another agency's regulations are at issue, CBP will seize the imported merchandise while the sister agency brings a parallel administrative enforcement action. Penalties for export control violations, overseas bribery and sanctions violations can be astonishingly severe, routinely in the millions of dollars. Each agency has its own enforcement regime, regulations and personality, so effectively responding requires skill. Unfortunately, when agency

enforcement actions do arise, the cost of defending them and paying any fines imposed quite often exceeds the value of the goods themselves.

Neuschul: The penalties are as varied as the ways in which a company can violate various rules and regulations. The financial penalties can be quite draconic – and surprising – in some cases. A common misconception is that if a good is imported duty free into a country, the risk of penalties must be low as well. Violations do not have to result in a loss of revenue for a government in order to be financially high. In case of import violations, the penalties are usually assessed as a percentage of value of the goods, or as a percentage of the VAT that was payable on such imports. When compounded over time and with penalty interest, and given they are not tax deductible either, the amounts add up quickly. On the other hand, with export controls related violations, the penalties can also add a business and reputation risk dimension, where a business loses its export privileges.

Cruz: Non-compliance with customs and export control regulations may expose the company to financial risk, such as tax and customs fines, which are mostly calculated as a percentage over the violation transaction amount, administrative offences and failures in customs audits. There may also be business disruption, including reviews of permits and

licences, loss and or discontinuation of agreements, transactions investigation and further audits.

Smith: The obvious penalties are monetary, which, depending on the size, may or may not be material. But companies need to understand the strategies used by regulatory agencies for enforcement. Most developed nations do not use monetary penalties as a form of revenue collection; rather, their intent is to change behaviour. If a company demonstrates cooperation and a true willingness to correct errant behaviour, monetary penalties are often mitigated and proportionate. However, egregious, fraudulent actions, or violations related to national security, can result in monetary fines in the millions of dollars – amounts large enough to send a clear message to others who might be so inclined. While financial penalties are effective in driving behaviour if they are large enough, the most concerning penalty for a high volume global trader is the possibility of debarment. The total loss of import or export privileges could in effect extinguish a company's existence in certain markets. Not good.

RC: What benefits can new technology and software offer as a mechanism for conducting due diligence and maintaining international trade compliance?

Neuschul: High quality global trade management software has been on the market for quite some time

now. There are tremendous benefits that a company can reap from automating its trade processes. This holds through from the basic, transactional level – such as housing trade data and interacting directly with brokers or forwarders – to very complex trade compliance programmes that manage sensitive technologies, deemed export considerations and multijurisdictional licensing requirements. These systems enable trade professionals to monitor compliance, speed up logistics processes, maintain integrity of the trade programme, and provide metrics and reporting capabilities. Trade automation is now a standard for a best-in-class trade compliance programme, and as companies have an ever-increasing trend of growing their global footprint, some level of trade automation is becoming essential.

Smith: New technology and software can provide control. The complexity of global regulations presents enough risk alone to keep a trader up at night, but the real challenge is volume. The sheer number of global transactions taking place during any given day, week or month can be overwhelming. Each transaction presents a risk on multiple fronts and systemic errors can impact hundreds of transactions if not identified quickly. Technology allows systemic controls to be embedded in the transaction at multiple levels that can notify someone when something goes wrong or, could completely stop a violative transaction. Further, advanced data analytics

provides insight on risk management at a deeper level than ever before. Risks can be more easily identified, controls can be put into place, audits can be performed on 100 percent of the transactions and records can be produced to support due diligence using trade software.

Cruz: When business is conducted in countries that are subject to extensive sanctions, companies have to undertake appropriate due diligence measures, such as checks on ownership structures, to ensure that appropriate compliance measures are in force. Technology does enable easy access to data, with risk measurement and regulatory measures assisting implementation mechanisms.

Cone: Over the past decade, software has proliferated as a compliance and strategic trade tool. For example, multinationals utilise databases to identify trade opportunities such as countries producing low cost inputs, or the customs duties applicable in various countries where they intend to ship goods. While software is a helpful but non-authoritative guide for determining customs duties and relevant export controls, software is absolutely crucial to ensure compliance with respect to certain sanctions platforms, such as the US regime administered by the Office of Foreign Assets Control (OFAC). OFAC publishes a list of ‘bad guy’ companies, individuals and even cargo vessels that companies are forbidden to do business with. The list can

change without effective notice and violations can result in confiscatory government action. Under OFAC, companies need to know their customers, input details on new business partners and wait for the software to return a green light before entering into contracts.

RC: What final piece of advice can you give to companies in terms of developing and managing an effective international trade compliance programme, to reduce related risks?

Smith: Companies should develop and maintain a compliant culture. In the US, the Sarbanes-Oxley Act (SOX) did a great job of creating compliance awareness in the C-suite, so a good first step in developing an effective trade compliance programme is to align it with the finance/tax function organisationally which could also align it with SOX. The importance of getting support from the CEO cannot be overstated. If need be, start with the CFO, but in either case, V-level support is paramount. And, it is usually pretty easy to get since they are the 'go to jail' people. They have a vested interest in making sure a compliance programme is successful. The next challenge will be getting the mid-management level to support the programme by making it part of their performance metrics. Remember, in a compliant culture, most people want to do the right thing; your job is to show them how.

Cruz: It is important for companies to monitor their trade-related performance in core areas such as export control, customs compliance and trade data management. Key performance indicators should also be created, with regular internal assessments, mitigation actions and implementation follow ups. Critical deviations from expected trends should also be identified and monitored. In addition, companies are well-advised to develop and implement a risk management process with a robust and 'waterproof' structure.

Cone: An effective programme begins with a top down commitment to compliance. Senior management should provide its full support to the global regulatory compliance effort and designate a manager responsible for it. A written compliance manual tailored to the company's operations should be implemented. The compliance manager should ensure that the compliance protocols set forth in the manual are followed, and perform periodic internal compliance audits. Internal controls should include protocols for addressing compliance failures, reporting violations to regulators where it is mandatory and disclosing them voluntarily when doing so is not required but is likely to produce governmental clemency. While a robust compliance programme requires time and money, the expenses and internal disruptions associated with enforcement actions can be far more costly. Nor should the lack of prior issues lull companies into complacency,



as agencies are full of surprises and always on the lookout for the next enforcement opportunity.

Neuschul: One of the primary considerations for developing a well functioning trade programme is to ensure that the company's management has an appropriate understanding of the importance of this function. Consequently, it is important to position the trade function at a high and central enough spot within the company management structure to enable it to have appropriate insight and ability to influence major business decisions – such as those pertaining

to finance/tax and legal issues. The specifics of this will depend on the company's profile, global footprint and appetite for risk. It is also important that the global trade compliance leader has a profile that enables her or him to understand tax, legal, accounting, operations, logistics and other areas to provide full value to the company. A common mistake some companies have made historically is to base their trade compliance function solely within the logistics and transportation sector, which ultimately results in an inability to act proactively to manage compliance risks. **RC**