Global Customs Risk Management
An Examination of Leading Practices
Ernst & Young, a global leader in the professional services, is committed to restoring the public’s trust in professional services firms and in the quality of financial reporting. Its 100,000 people in 140 countries pursue the highest levels of integrity, quality, and professionalism in providing a range of sophisticated services centered on our core competencies of auditing, accounting, tax and transactions. Further information about Ernst & Young and its approach to a variety of business issues can be found at www.ey.com/perspectives. Ernst & Young refers to all the members of the global Ernst & Young organization.
The globalization of corporate operations has created remarkable opportunities for business, along with creating corresponding global customs risks. Risk management has emerged among global traders as a primary objective of the corporate import function, and companies are increasingly undertaking efforts to proactively manage customs risks on a coordinated global basis. Process and control-focused approaches have proven worthwhile. Many of the world’s leading companies are achieving risk mitigation through globally oriented internal control systems that embrace coordinated corporate-wide standards, yet respect and allow for interplay of unique laws, cultures and operations.

Companies report that risk management of the import function involves much more than regulatory compliance. Risk management includes enhancing corporate opportunity through paying the “right” amount of duty, not more or less than is legally owed. Risk management also addresses the efficiency and effectiveness of import operations critical to business. Effective risk management considers regulatory compliance, financial results, and operations. Managing customs risk supports a company’s international competitiveness in today’s global marketplace.

The Customs and International Trade practices of the Ernst & Young global network invited a select group of key executives from wide-ranging industries to examine leading practices for managing global customs risks. Each participant company is an established importer in multiple jurisdictions throughout the world, recognized as a leader in its respective industry, and centrally manages risks on a global or regional scale. Following a facilitated discussion format, participants expressed views on what successful risk management looks like in practice, including risk assessment activities, approaches to jurisdictional variances, customs incorporation into corporate initiatives, supply chain planning and tax structures, as well as ongoing auditing and monitoring activities.

This report summarizes the findings of leading practices in corporate risk management of the import function. We hope the report provides valuable insight.

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“Risk management remains a primary objective of the corporate import function.”
# Table of Contents

**Introduction: A Focus on Risk Management** .................................................. 1  
Why select “Risk Management” as a single focus for Ernst & Young’s Global Best Practices Symposium? .................. 1  

**Workshop Format** ........................................................................................................ 3  

**Global Risk Assessment** ............................................................................................ 5  
  
  - SAS Framework of Internal Controls .................................................................. 5  
  - Risk Identification .......................................................................................... 6  
  - Ownership of Global Customs Risk .................................................................. 6  
  - Responsibility for Conducting Risk Assessment .............................................. 7  
  - Data Gathering and Measurement Activities ................................................... 7  
  - Communicating Risks to Management .............................................................. 8  
  
  **Managing Jurisdictional Diversities** ........................................................................ 13  
  
  - Jurisdictional Factors Generating Customs Risk .............................................. 13  
  - Resulting Risks or Consequences ..................................................................... 15  
  - Mitigating Risks Arising from Jurisdictional Diversities ................................. 15  
  - Summary of Key Findings ............................................................................. 16  
  
  **Keeping Up with the Company** .............................................................................. 17  
  
  - Changes to the Supply Chain .......................................................................... 17  
  - Mergers and Acquisitions ............................................................................. 17  
  - Other Transactions ....................................................................................... 18  
  - Systems and Data ............................................................................................ 18  
  - Approach to Managing Risk ........................................................................... 19  
  - Summary of Key Findings ............................................................................. 20  
  
  **Subject Matter Risk Management** ......................................................................... 21  
  
  - The Need for Subject Matter Approach .......................................................... 21  
  - Risk and Reward ........................................................................................... 21  
  - Related Party Transactions ............................................................................ 21  
  - Summary of Key Findings ............................................................................. 22  
  
  **Auditing and Monitoring** ....................................................................................... 23  
  
  - Importance and Benefits of Auditing and Monitoring ................................ 23  
  - Necessity of Corporate Sponsorship at Executive Level ................................. 23  
  - Defining the Audit Scope ................................................................................ 23  
  - Audit Teams .................................................................................................... 25  
  - Audit Tools and Implementation Techniques ................................................... 26  
  - Monitoring Activities ...................................................................................... 27  
  - Monitoring Tools .............................................................................................. 28  
  - Communicating Findings and Ownership of Compliance Improvement Steps. . 29  
  - Summary of Key Findings ............................................................................. 30  
  
  **Concluding Thoughts** ............................................................................................ 31  
  
  - Correlation with Corporate Risk Management ............................................. 31  
  - Key Factors to Successful Risk Management .................................................. 31  
  - Commonalities of Leading Risk Management Practices ............................... 32  


“Managing customs risk supports a company’s international competitiveness in today’s global marketplace.”
Introduction: A Focus on Risk Management

Why select “Risk Management” as a single focus for Ernst & Young’s Global Best Practices Symposium?

Risk management is the principal issue on the minds of customs executives. During the 2004 Ernst & Young Global Customs Best Practices Symposium, executives stated unequivocally that risk management is the primary objective of the global import function. They expressed that proactive risk management is a leading practice.

A clear focus on risk management is also a priority for corporate leaders navigating the worldwide increase in regulatory and corporate governance requirements. Ernst & Young has conducted a series of research surveys exploring corporate leadership viewpoints on risk and risk management. Ernst & Young’s Companies on Risk: The Benefits of Alignment, published in April 2006, reports key findings of over 400 corporate leaders, including CEOs, CFOs, and Chief Risk Officers.

Findings include:

- Two-thirds of respondents perceive a rise in risk levels over the last two to three years; one-third of respondents believe the overall levels of risk they face have significantly increased.
- Forty-two percent of respondents believe they have gaps in risk coverage.
- Nearly 4 in 10 companies do not have formal processes to align risk management with corporate strategy.
- Further alignment is needed between risk management functions and line management, as well as across individual functions.
- Risk management challenges of the next three to five years include developing a more integrated and systematic approach, clarifying ownership of risk, and embedding a risk culture throughout the organization.

Overlaying responses in Companies on Risk: The Benefits of Alignment pose questions about whether gaps in customs risk coverage exist, whether risk management of the import function is aligned with corporate strategy and across functions, whether and how customs risks are being addressed systematically across global operations, and whether ownership of customs risks is defined. Our 2006 Global Customs Best Practices Symposium presented an opportunity for detailed exploration of these questions, by examining what global proactive risk management of the import function looks like in practice.
“Customs risk is not owned by a single department or individual, which complicates risk assessment and management.”
Workshop Format

The symposium followed a facilitated workshop format. This report summarizes the discussion and highlights the comments made by participants during the discussion; quotes, however, are not attributed to any individual. Opinions expressed are those of the individual participants and are not necessarily those of the organizations they represent.

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Names and contact information of the Ernst & Young participants are listed at the end of this report (see page 33).
“Changes in business structure or operation most often have customs consequences.”
Global Risk Assessment

According to the American Institute of Certified Public Accountants (AICPA) Codified Professional Standards, risk assessment is formally defined as “the entity’s identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.” Risk assessment serves as a core around which internal controls are framed and is a foundation for effectively managing risks.

Participants in Ernst & Young’s 2004 Global Customs Best Practices Symposium collectively agreed that implementing a formal risk assessment model is a leading practice for managing customs risks. These experienced importers also noted the significance of obtaining reliable global data in order to successfully assess and manage risks, an exercise that had proven particularly challenging on a global level.

This year’s symposium discussions built upon the identified leading practices of formal risk assessment and global data gathering and moved into implementation techniques. Multinational traders shared experiences on what formal risk assessment activities and global data gathering actually look like in practice within their organizations. Specifically, participants addressed:

- Identification of customs risks
- Ownership of customs risks
- Responsibility for conducting customs risk assessments
- Assessing and prioritizing risks among jurisdictions and divisions
- Data gathering and measurement activities
- Communicating identified customs risks to upper management

Need for corporate mandate and cross-functional and jurisdictional cooperation

SAS Framework of Internal Controls

Risk assessment is a necessary component of corporate internal controls, as outlined by the AICPA in its Statement on Auditing Standards 78 (SAS 78), published in December 1995. The SAS 78 approach is process and control based. Symposium participants identified the application of the SAS 78 framework to the customs functions as a leading practice.

As one of five control components of the SAS 78 framework depicted below, risk assessment is a key element to achieve three primary corporate objectives across all functions and units of the entity: reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The customs function impacts all three corporate objectives: financial reporting, operations, and compliance.
and compliance. Consequently, the approach to, and anticipated results from, a customs risk assessment closely parallel those undertaken by the company generally.

It was also noted that with respect to U.S. importations, the U.S. Bureau of Customs and Border Protection (CBP) applies the SAS 78 framework during customs audits to evaluate internal controls and requires members of its Importer Self-Assessment Program (ISA) to base internal controls on SAS 78. CBP, of course, is focused on the “compliance” objective of SAS 78, anticipating that companies with strong internal controls and oversight will achieve the highest level of compliance.

**Risk Identification**

Risk identification was noted by participants as one of the most important, but also one of the most challenging parts of effective risk management. Customs risks include items somewhat obvious to the function, such as the risk of regulatory compliance violations, as well as other not-so-obvious business, financial, or personal risks that should also be assessed by the company. Participants categorized customs risks as follows:

- **Regulatory/Compliance Risks**
  - Violations of Customs Laws
    - Valuation
    - Tariff classification
    - Country of origin declaration and product marking
    - Duty payments

- **Financial Risks**
  - Overpayment of duties
  - Penalties imposed due to compliance errors
  - Inaccurate accrual or reserves for customs payments/exposures
  - Legal fees

- **Business Risks**
  - Failed Corporate Strategies
    - Failure to employ optimal decision-making by not recognizing the inverse relationship of initiatives or strategies to duty reduction (e.g., low-cost sourcing initiatives or supply chain structural changes that inadvertently increase duty liability)
  - Lost Opportunities
    - Free Trade Agreement (FTA) oversight
      - Failure to use FTAs where qualification is possible (i.e., overpaid duties)
    - Unintended FTA disqualification due to uncoordinated sourcing changes (i.e., creating additional duties)
  - Product sourcing from jurisdictions carrying higher duty liability

- **Transfer Pricing Errors or Complexities**
  - Unintentionally limiting or threatening income tax position on transfer pricing due to inconsistent customs declarations
  - Creating customs valuation errors or complexities with transfer pricing policies or adjustments

- **Supply Chain Disruption**
- **Security Breaches**
- **Damage to Corporate Reputation**

- **Personal Risks**
  - Imprisonment
  - Damage to Individual Reputation or Licensure
Ownership of Global Customs Risk

Clear ownership of risk impacts an organization’s ability to effectively assess and manage risks. The Ernst & Young survey of over 400 corporate leaders revealed “clear ownership of risk” as the single most highly cited factor for successfully managing risks. Identifying the person or function that owns customs risks within a company can be an elusive process and may present gaps in coverage. As noted by symposium participants, customs risks impact all three SAS 78 corporate objectives (reliability of financial reporting, effectiveness and efficiency of operations, and compliance with laws and regulations) and fulfillment of these objectives crosses functional lines.

“Whose risk is it?” The question was posed to participants. Deliberations resulted in collective agreement that multiple departments or individuals in the company own customs risks as stakeholders.

If an internal control over the customs function fails, the cost may be recognized by any number of departments: procurement, manufacturing, supply chain, or finance, as examples. The corporate compliance department or customs function, in turn, has the responsibility to educate and communicate risks to other stakeholders. The participants could not, however, generally point to an individual or department in their own companies that had both singular ownership of, and responsibility for managing, all customs risks. Without singular ownership of risk, it was also difficult to identify a single person or department that had authority to take action to manage risks. This further complicates risk management, requiring a cooperative, multifunction approach to be effective.

Responsibility for Conducting Risk Assessment

The responsibility to conduct risk assessment activities varied by company. About half of participant companies maintained a global corporate compliance function that was, among other things, responsible for conducting risk assessments. Other companies used a combination of internal audit, legal, customs department personnel, and outside consultants to conduct risk assessments. Overall, the group generally agreed that it is a leading practice for the corporate compliance or customs compliance departments to own the responsibility of ensuring that global risk assessments are conducted, and teams can be assembled in various ways. The teams must have technical knowledge and must include or work closely with individuals located in the operating jurisdictions.

Makeup of global risk assessment teams also varied between using a single resource versus separate regional resources. Some participants noted the importance of having a consistent person or team conducting risk assessment activities globally. A single resource assures proper training, consistent application of assessment tools and internal controls, and understanding of how local risk assessment relates to larger global operations. Others used regional teams to conduct certain assessment activities. It was noted that high turnover among regional employees in certain markets can present problems and leave no one capable of conducting local reviews.

In all, the group agreed that some centralization and standardization across global risk assessment activities is a leading practice, and that each company must look at its resources, organizational structure, and available personnel and partners to best form its risk assessment team.
Data Gathering and Measurement Activities

Risk assessment can succeed or fail based on the availability of accurate and meaningful data to review.

Data Pertinent to Risk Assessment

Companies considered it important to analyze both qualitative and quantitative data. Blending objective and subjective elements was a common theme in participants’ risk assessment activities. Data noted by participants as pertinent to their risk assessment included:

- Import value
- Duties paid
- Duties avoided through preference claims
- Product flows
- Written procedures and recordkeeping
- Operational adherence to written procedures
- Import process steps and internal controls
- Knowledgeable personnel conducting import function
- Penalty history
- Audit history

Methods for Gathering Data

Data gathering methods found useful by participants include the following; most companies employed some combination of these tools and approaches.

Questionnaires. Risk questionnaires are categorized into global and country-specific questions and presented for response by those conducting the customs function. Results of questionnaires can be used to develop standards for managing risks worldwide. Participants did note, however, that questionnaires initiate activities, and must be validated with personal meetings and objective data.

Internal Websites were described as useful tools to gather key data elements and responses from employees in locations around the world.

On-Site Interviews. Consensus was that site visits and/or telephone interviews are warranted to verify and expand on written questionnaire responses. In-person contact allows risk assessment teams to subjectively evaluate the knowledge of the customs personnel conducting the business and the accuracy of the information they provide. One participant noted that individuals and entities that provide inaccurate data automatically receive a higher risk score.

Risk Matrices or Registers. Risk matrices organize elements that impact customs risks, such as trade value, sales data, duty paid, duty rates, duty avoided, audit history results, and reviews by outside consultants. Risk matrices highlight single issue risks as well as provide an overall picture of risks relevant to a business unit or geography. Participants using risk matrices explained that specific risks were typically assigned a numerical score or a high, medium, or low risk ranking. The combined results were then used to assign an overall score or weight to customs risks in that business unit or region. Risk matrices were noted as useful tools to determine specific areas for evaluation, the type of transactional testing to be performed, and prioritization of focus.
Information Systems. Corporate data gathered via enterprise resource planning (ERP) and other business systems can be used to provide an objective or quantitative element to risk assessment. Participants noted that no information system provides all information needed to sufficiently assess risks, particularly on a global level. However, information systems can assist in gathering objective data, confirm overall product flows by value and volume, and assess duties paid or likely avoided through preference claims. At a summary level, participants felt that incorporating reports from corporate information systems is a leading practice necessary to successful risk assessment.

Shared information systems (intranets, or other shared access systems or websites) were also noted as a valuable repository of centralized information from personnel in multiple jurisdictions, across functional lines, or from third party representatives. Shared systems allowed for timely quantitative and qualitative data input from multiple sources.

Process Mapping. Process mapping is an exercise to create a formal flowchart view of all elements involved in the import process, from purchase order generation to accounts payable. Graphically depicting the import process across company locations, operating divisions and business units makes it possible to identify areas needing improvement and opportunities to enhance the business processes.

Process mapping to formally flowchart internal controls is a popular risk assessment tool among participants. One participant commented, “Process maps help us find the interdependencies between groups. By process mapping you find the disconnects.”

Prioritizing Risk Assessment Activities
Deciding how best to allocate risk assessment resources is an important aspect of risk management. Focus on the consequences of internal control failures – asking “what can go wrong?” – requires the application of expertise and the exercise of good judgment. This allows resources to be prioritized to address higher risk areas first. The consensus was that simply looking at the amount of import activity (e.g., number of importations made by business unit or jurisdiction) is insufficient to prioritize risks. Additional quantitative and qualitative factors must be incorporated into the prioritization, including:

- Market size and importance to company
- Duty paid
- Use of preferential trade programs and savings
- Location of facilities and particular jurisdictional sensitivities, level of staffing and organization
- Compliance history
- History of penalties or identified errors
- Clarity of law on subject matter or by jurisdiction

Establishing Financial Reserves
Executives of several participant companies described their company process of establishing financial reserves to offset potential liabilities or additional duty payments. When considering reserve allocation, no dominant practice emerged. Some companies accrue only when specific, known risks or errors arise. Another participant explained a method of using values associated with prior underpayments or penalties as a basis to establish reserves. Another company maintained a general accrual account for customs.
It should be noted that these approaches may or may not be consistent with Generally Accepted Accounting Principles (GAAP).

**Communicating Risks to Management**

Communicating customs risks to management is important throughout the risk assessment process. First, there must be a general understanding of risk in order to obtain management’s mandate for customs risk assessment. Second, communicating risk assessment results and needed remedial action is necessary to mitigate the identified risks. Both were noted as fundamental to successful risk management.

**Corporate Mandate for Risk Assessments**

Consensus was that risk assessment, to be effective, requires cooperation across functional and jurisdictional lines within the company. Knowledgeable people “in the trenches” are key. Purchasing, finance, legal, internal audit, customs compliance, and business personnel were all named among departments that should cooperate in the process. By leveraging the expertise and corporate knowledge of multidisciplinary individuals and departments, risk assessment team leaders can more rapidly and accurately assess risks.

Consequently, sponsorship for the risk assessment needs to come from a person or persons that will cause the necessary cooperation. This is more likely to occur if potential customs risks, and consequences of those risks, are clearly understood.

**Target Audience**

Company representatives agreed that risk assessment results are of no value unless communicated to and from persons or departments with the ability to close the gaps and implement opportunities. Cross-functional teaming was noted as a leading and necessary practice, as well as a challenge in some respects. For example, the risk assessment team may need the authority or influence of the legal department or of C-level executives in order to deliver a message on necessary risk mitigation steps or to guide necessary change. Participants noted that to manage risk effectively, multiple departments are needed at the same table. Departments of particular importance are legal, tax, and the related operational departments that either impact or are impacted by the risks. Examples include procurement, manufacturing, or logistics, depending on the risks identified.

**Delivering a Clear Message to Stakeholders**

As with any message, consideration of the audience is imperative. Symposium dialogue covered a variety of leading practices used to communicate customs risks to stakeholders. Telling a “meaningful story” involves considering factors relevant to the audience at hand, such as:

- Personal and departmental goals or risks
- General interest level or understanding of customs risks
- Departmental impact on customs risks
- Potential to directly benefit from duty saving or supply chain opportunities
- Ownership over the process
- Tolerance for risks

Participants noted the necessity to “speak their language” when communicating customs risks to other departments or executive-level management.
Messages Found Useful in Conveying Risks to Management
- Quantified duty-saving opportunities
- Reduced cost of goods sold estimates
- Explanation of legal violations
- Disclosing penalty amounts issued to company and other companies
- Examples of incarceration or extreme enforcement in jurisdictions
- Customs impact on financial reporting, the potential for restatements
- Supply chain speed and predictability via resilient customs processes
- Threat of reputational risks
- Sarbanes-Oxley considerations
- Customs impact on or support of core corporate values or goals

What works for one audience may not work for another, a point agreed on by all participants. As one company representative commented, “I have a variety of tricks in my bag when I present risks, and I pull out what I think will work for my audience.” Consensus is that the leading practice for communicating risk assessment results is simply whatever legitimate method or combination of methods garners appropriate attention and action by cross-functional departments and executive-level personnel. Having done that, customs personnel have satisfied their obligation, as identified by participants, to communicate risks to all owners or stakeholders in the company.

Summary of Key Findings
Customs risk is not owned by a single department or individual, which complicates risk assessment and risk management.

Risk assessments should:
- Be process-focused, using an SAS 78 framework
- Be conducted by persons with customs technical knowledge
- Directly involve knowledgeable people “in the trenches”
- Apply centralized standards to the extent possible, yet allow for localization to jurisdiction and operation
- Analyze both quantitative and qualitative information
- Be sponsored by corporate leadership who can drive cooperation, close gaps, and implement opportunities
- Be communicated to stakeholders in their terms
“Managing customs risk is complicated. An integrated approach – with senior management sponsorship – is essential.”
Managing Jurisdictional Diversities

The 21st century has been shaped by international trade to an unprecedented degree. Global businesses are expanding operations to penetrate new markets and make the most of sourcing and manufacturing opportunities in low-cost jurisdictions. As companies broaden their global footprint, jurisdictional diversities in law, practice, and culture become more critical to successful risk management.

In *Global Customs Best Practices: 2004 Symposium Report*, some of the most established global traders stated that implementing a standard global framework of internal controls over the import function with local customization for each jurisdiction is a leading practice. All symposium participants represented multinational importers that implement, to varying degrees, coordinated risk mitigation strategies over global customs operations. This backdrop of experienced multinational importers allowed dialogue to focus on explicit accounts of:

- Jurisdictional factors that increase customs risks
- Specific risks arising from jurisdictional diversities
- Internal control standards and/or localization that work best in practice
- Approaches and tools to effectively manage these risks

Participants expressed the opinion that global customs risks are increasing and becoming a greater priority. This finding is particularly interesting as the accession to the World Trade Organization (WTO) and adherence to the Kyoto Accord has led a number of countries to implement post-entry audit procedures for the first time. Participants noted that risks in developing countries, even if relatively minor markets, consume significant corporate resources.

### Jurisdictional Factors Generating Customs Risk

The session began with consideration of what jurisdictional factors, if any, actually generate customs risks. Executives pulled from a variety of first-hand experiences of jurisdictional factors that had created or increased customs risks for their international operations. Primary factors identified fall within several categories.

#### Customs Laws Not Truly Harmonized

Executives recognized that different legal frameworks govern customs operations and that lack of harmonization creates risks requiring particular attention. Participants noted that customs laws are not harmonized globally, and frequently within many developing countries, are applied inconsistently within the country itself based on local interpretations. These interpretation differences exist across borders even where rules are formally harmonized via the General Agreement on Tariff and Trade (GATT). In fact, for many companies, the appearance of complete harmonization can create a false sense of security, an assumption that an approach is correct because it has been accepted elsewhere. Thus, simply applying a GATT approach without application of local principles is insufficient to mitigate risks.
Administrative Procedures and Philosophy of Authorities
Symposium participants agreed that local administrative procedures and general philosophies of customs authorities differ wildly across the globe, thus increasing risks if companies apply a “one size fits all” approach. One company representative described, as an example, how a minor documentation error could provide the basis for a smuggling allegation in China. Others relayed similar stories of severe approaches undertaken in Latin American countries, by Latin American authorities (i.e., a customs “error” resulting in threat of business disruption and personal repercussion). The point was clearly made that risks increase when companies understand and plan only for technical rules without also understanding local administrative processes, enforcement mechanisms for rule violations, and the general philosophy of customs authorities.

As noted by multiple participants, this is exacerbated in developing countries that often take significantly harsher enforcement or revenue-generation approaches than those applied in more developed countries.

Variance or Absence of Post-Entry Correction Mechanisms
Many participants also emphasized the difficulty created by a lack of administrative post-entry correction or voluntary disclosure procedures in a significant number of countries. Executives commented: “There is no procedure to correct errors.” “Customs authorities consider an error an intentionally illegal act.” “The position forced in many countries is to make a mistake and wait.”

Excessive Enforcement Tactics in Developing Markets
The use of excessive enforcement tactics was identified as creating serious risks in some jurisdictions. Several executives noted a correlation between a country’s focus on collecting customs duties and penalties as revenue with intimidation of company employees. In such instances, risks become more severe as authorities focus intimidation efforts on individual executives. One delegate relayed an experience in which a corporate executive was asked by customs officials to provide a duty payment on Christmas Eve or risk imprisonment until January 2. Another told of an experience where customs officials reopened a previously closed case coincident with an effort to meet annual revenue goals.

Lack of Appropriate Training and Knowledge
Participants noted that lack of employee training can lead to inconsistent processes and increased risks. Further, risks can be increased by the lack of knowledge of customs officials in many jurisdictions, as to things such as WTO rules, accounting procedures, and their own country laws. This is particularly pronounced in countries that have recently joined the WTO.

Language
All agreed that clearly communicating with employees, suppliers, business partners, and customs officials was important to risk management of the global customs function. Lack of strategy around language barriers was considered a risk. For example, participants noted that government communications are frequently sent in the local language, and some require immediate replies in the local language. Similarly, participants noted cases where internal documents supporting customs compliance and declarations frequently require translation.

Language barriers can also create risks within the context of internal training and operational controls. One participant noted that without working with translators on the substance of the training (such as
reviewing presentations and instruction materials), the company could not otherwise insure accurate translation of the training materials, technical terms, requirements, and processes.

**Resulting Risks or Consequences**

When asked to identify specific risks resulting from jurisdictional diversities in law, administrative practice, or culture, participants identified risks that were operational, financial, and personal in nature. Companies had experienced or been exposed to the following risks:

- Overpayment of duties
- Penalties
- Inefficiencies
- Duplicative costs
- Government closure of facilities
- Loss of import/export privileges
- Personal fines or imprisonment

**Mitigating Risks Arising from Jurisdictional Diversities**

Executives agreed that there are many useful approaches to standardizing internal controls across jurisdictions, but that there is no “one size fits all” solution. Despite the need for customization via company and jurisdictions, symposium participants employ various noteworthy strategies.

**Know the Local Laws**

First and foremost, companies need to understand the laws of the jurisdiction, and create controls which ensure compliance with local requirements. Tied to this, one participant emphasized knowledge of both direct and contractual obligations.

**Standardize and Execute Processes to the Extent Possible**

Standard global processes that are consistent with local requirements should be established and followed across the company and operating jurisdictions where possible. Participants noted that areas which may require more localization than might be initially anticipated include classification and valuation. This experience is consistent with previous comments that risk is increased by false assumptions that rules based on harmonized GATT codes, such as the Harmonized Tariff Schedule (HTS) and Valuation Code, are applied consistently worldwide. Once in place, it is vitally important that processes are followed. One participant noted that problems begin when companies fail to execute their processes 100%.

**Understand the Focus of Local Officials**

Communicating with local officials and understanding their focus is an important strategy for risk mitigation. An understanding of the enforcement focal points allows proactive risk management, directing resources to areas expected to receive scrutiny. This can be an understanding, as one participant noted, of industries, products, or preference claims targeted for entry review or audit. It could also include, as another explained, an understanding of the level of entry scrutiny versus post-audit approach.
Establish a Local Presence
Participants unanimously agreed on the value of having local employees on the ground, but recognized the practical difficulties of having a knowledgeable, dedicated resource in all jurisdictions. When a dedicated resource is not available, it is important that responsibility is clearly established. One participant commented that if “customs” is not in an employee’s job description, accountability can become an issue.

Maintain Relationships with Knowledgeable Partners
Knowledgeable employees and supply chain partners on the ground are key to successful operation and mitigation of customs risks across jurisdictions. Critical expertise required of these partners includes the ability to speak the local language and knowledge of local rules in both law and practice.

Team with Customs Advisors
Strong relationships with local advisors is a leading practice. One participant noted that working with advisors provides a good learning experience and encourages continuous process improvement. Participants discussed reaching out to local consultants and law firms. However, the group did not reach consensus on the value of using customs brokers as local resources. Some participants were concerned with potential conflicts of interests, technical abilities, or consistency of quality standards among local customs brokers, while others had experienced successful teaming with brokers.

Conduct Regular Audits
Annual audits of both standardized and local procedures are valuable tools to facilitate risk identification and mitigation across jurisdictions.

Communicate with Local Authorities
Participants believed regular communication with local authorities is important. One participant spoke of success communicating directly with local agencies regarding company processes and policies in countries such as India and Turkey. This process increased local understanding and ultimately led to approval of transactions previously questioned.

Customs Procedures in the Local Language
Some participant companies had drafted written customs compliance procedures in the local language and found them to be a valuable reference tool for employees.

Summary of Key Findings
Jurisdictional diversities may be effectively managed by
- Application of a standard global framework of procedures, with localized content
- Local presence and technical knowledge
- Avoiding false assumptions that harmonized GATT rules are consistently applied
- Understanding the local authority priorities and processes
- Teaming with knowledgeable partners/advisors
Keeping Up with the Company

While customs issues typically do not drive business decisions, changes in business structure or operation often have customs consequences. Because business dynamics cause risk, it is incumbent on those managing the customs function to react to changes in risk caused by changes in the business.

In Global Customs Best Practices, 2004 Symposium Report, participants felt that the customs function should respond to and influence corporate initiatives as a leading practice. This “reciprocal aspect” of the customs function with corporate planning was also apparent in this year’s symposium discussions. It is important to be aware of and react to changes in the business; it is equally important to review potential customs consequences and possible alternatives before implementing business changes. Specific corporate activity giving rise to customs risks, and leading practices to reduce those risks, are outlined below.

Changes to the Supply Chain

Supply chain changes were cited as the most frequent type of business change impacting customs risk. Managing the consequence of origin changes was noted as particularly important. Change in location of manufacturing from one country to another, whether caused by changing suppliers, the supplier changing manufacturing locations, or internal manufacturing decisions, can have significant consequences. “Moves to China have impacted our ability to sell with TAA qualification,” stated one participant, elaborating that Trade Agreement Act qualification impacts product eligibility for sales to the U.S. government, as well as sales to other governments. “Goods we were selling into Mexico now have a 30% to 35% duty because they are of Chinese origin,” explained another participant. Changes in sourcing can also affect eligibility of resulting products for free trade agreements. For example, changes to China sourcing for component parts destined for manufacturing in Mexico can impact the qualification of the finished Mexican product under the North American Free Trade Agreement (NAFTA). As in the merger and acquisition area, being viewed as an important part of the decision-making process allows the customs risk to be best managed.

Even changes in supply chain partners, such as carriers, brokers, and third-party logistic providers present challenges for risk management. These changes can affect obligations under the Customs Trade Partnership Against Terrorism (CTPAT), as well as changing sources or formats of data. Noting that “brokers play very different roles in different jurisdictions,” one participant highlighted the importance of carefully managing broker changes across the globe.

Mergers and Acquisitions

Current merger and acquisition activity in the market has made transactional due diligence a high profile item for customs risk management. More than half of the symposium participants have directly participated in transactional due diligence reviews at their companies. Pre-acquisition due diligence was quickly identified as essential to recognize and mitigate risks. The focus of the customs portion of the review, however, somewhat varies from that generally conducted on other aspects of the target. Mirroring the dual financial and operational aspects of the customs function, an effective customs due diligence review looks to both financial and operational aspects of the target. As with general financial due diligence undertaken by the acquiring company, customs due diligence looks for potential liabilities of the target.
In addition, varying from the approach taken with many other aspects of a due diligence review, the customs review also attempts to get a good picture of the target’s operational practices. This is important because of the transactional basis for customs reporting. On the day following closing, the target, absent instruction from the new owner, will be conducting operations in the same way as it was prior to the acquisition. If there are gaps or systemic errors inherent in the target’s process, new violations will occur post-acquisition, which will be the responsibility of the buyer, not the seller. For example, an error in the tariff classification database or free-trade agreement qualification process can cause new liability for the purchaser on the very first post-closing imports. To try to mitigate this risk, it is very important that the due diligence review include some review of current operational practices.

Pre-acquisition due diligence is often conducted with very short lead times and limited access to data. Consequently, it is important to be “ready to go” on short notice. Having due diligence workplans, including information requests and checklists, was noted as essential to being able to respond quickly, and make the most of the allotted timeframes. Flexibility in approach, however, is also important. Consideration should be given to the experience of the target and its personnel, as well as to the target’s specific supply chain, in focusing pre-acquisition due diligence.

Recognizing that due diligence reviews are necessarily limited in time and scope, post-acquisition integration was noted as vitally important to managing risk. “Be prepared to have a due diligence checklist, know what to look for, and be ready for integration,” was one participant’s summary of the needed approach to managing risk from acquisitions.

Participants noted that some important information necessary to properly manage risk may be hard to obtain in a pre-acquisition due diligence review. This includes the target’s relationship with regulatory agencies, specific operating procedures, and detailed information on sources of data and IT systems. Moving quickly into a process-focused customs integration plan is important to completely identify and deal with potential risks, regardless of how quickly actual business operations will be integrated.

Other Transactions

Dispositions
While often not as high profile as mergers and acquisitions, other corporate transactions also affect customs risks. Dispositions can impact resources important to operations. They can also affect potential recoveries, such as those attributable to duty drawback. Deciding “who gets potential liabilities” can also be an important aspect to planning for divestitures or sales.

Reorganization
Corporate restructuring can also impact customs risks. Reorganizations that make distributors “limited risk” can raise the basis for customs valuation. Use of commissionaires can eliminate the qualification for transaction value. Movement of design function to an entity in a different location can create assists, and movement of intellectual property can affect dutiability of trademarks. Consistent with the “reciprocal importance” theme of keeping up with the company, participants noted that there can be opportunities resulting from these types of restructurings. As with mergers and acquisitions, it is important to be included early in the planning process in order to have a positive influence on the planned transaction and appropriately manage the customs risk.
**Systems and Data**

Risk can also arise because of changes in systems or data. Customs functions have become highly automated and data-dependent. Inaccurate data can lead to supply chain disruptions and penalties. Even changes in the format of data, however, can increase these risks.

A business process/information technology roadmap helped one participant’s customs department assess the impact of business changes on data. All processes and systems impacted by customs are documented in the roadmap, and the tool was used to notify upstream and downstream of the impact of changes. While the participant acknowledged that this tool is a little bureaucratic, it reduces surprises: “The roadmap allows us to see what needs to be fixed together as a unit – we can create a bigger solution, a more long-term solution.”

**Approach to Managing Risk**

Symposium participants were easily able to define the necessary elements of successfully managing risk from changes in the business. However, even with the elements readily defined and understood, execution remained a challenge.

**Awareness**

Making sure those who instigate business change are aware of customs impact is critical. Most companies took multiple approaches to raising awareness. Global awareness training was frequently undertaken by the participant companies, both in person and using web-based learning. Having reference materials readily available and easy to locate in online databases was also described as very useful. A number of the companies had a formalized process for anyone in the business to ask questions about possible customs issues. Several companies used an e-mail “alias” to allow questions to be submitted to the customs department, which in turn helped awareness. Finally, tying into other risk management activities in the company was cited as being useful. One participant noted: “Discussions about Sarbanes-Oxley helped us reinforce that we need to be talking with upper management, because Sarbanes-Oxley is a core value from a financial discipline perspective. Sarbanes-Oxley is a driving force to keep customs at the forefront of the discussion.”

Keeping awareness at a high level requires an ongoing effort. Because business changes can be generated in a variety of situations, it is important to keep the effort constant, and to reach as many parts of the business as possible.

**Early Involvement**

The speed at which ideas materialize into actual changes was a challenge for every participating company. Consequently, as soon as a customs function becomes aware of a potential change, it is important to get involved in the process early. Regular dialogue with key business decision makers was noted as very important to learning of potential changes. There was consensus that becoming involved at the earliest possible time was the leading practice.

**Advance Preparation**

Being prepared to act quickly and impactfully was also important to managing risk. In the merger and acquisition area for example, the advance preparation of templates for due diligence was an example of being able to have quick impact, as was the example of the information technology roadmap used when there were possible information systems changes. Being ready to address potential business changes promptly will lead to more effective and efficient risk management.
Demonstrate Value
Consistent with the “reciprocal nature” of the relationship between the business and the customs function, being able to demonstrate the value of involving the customs function was a key to both managing risk from the transaction at hand, and “getting to the table early” for future business changes. Tangible examples of avoiding problems, or finding opportunities as business changes are contemplated, is perhaps the most effective way of becoming regularly and deeply involved in the process for business change.

When to Involve Customs Authorities
Participants discussed the difficulty in making the decision of how and when to inform customs authorities of changes in business structure. Several companies described positive experiences after initiating discussions with customs authorities on future plans in advance of planned change taking place. Others, however, cautioned that these decisions should be made with great care. “Speaking with customs may be beneficial in certain jurisdictions, but not all,” stated one participant. Another echoed the thought, noting that the impact of the proposed business change on specific topical areas could well impact a decision to discuss the changes or not. Changes in valuation methods, or in data-supporting valuation methods, were noted as a particularly difficult topic to discuss with authorities due to lack of clarity around rules and other variables.

Summary of Key Findings
The customs function should:
- Be involved in corporate strategy
- Educate and influence strategic initiative leaders about customs consequences and opportunities
- Raise awareness of customs risks throughout the company generally in order to obtain a “seat at the table”
- Develop a process and tools for prompt analysis and action
Subject Matter Risk Management

One session in the symposium discussed reviewing customs risk by subject matter. Valuation was selected for discussion because it is multidimensional. Valuation law is harmonized; the WTO Valuation Code provides the rules for establishing customs value in WTO member countries. At the same time, particularly with regard to related party pricing, rules are “facts and circumstances” based, often without much guidance as to specific application. Interpretations and enforcement practices vary by jurisdiction. Thus, valuation provides an interesting framework for a discussion on approaching risk management by subject area.

The Need for Subject Matter Approach

Particularly for subject matters where there is harmonization, evaluating risk by subject matter is viewed as an important part of a risk management program. “GATT and WTO rules mean more consistency across countries,” stated one participant “and allows for management by topic.” Often there are common gaps that can be identified across geographies relative to a specific subject matter, which can then be addressed simultaneously. In some instances, the data needed for regulatory compliance in multiple jurisdictions comes from a common source, so that thinking about risk by subject matter can be conducive to arriving at database solutions.

Risk and Reward

Much of the discussion centered on the risk/reward dynamic that is particularly evident in the valuation area, although it is not unique to valuation. Because most duties are assessed on an ad valorem basis, any methods which legally reduce the declared value of goods reduce duty. Consequently, companies that affirmatively arrange transactions to achieve valuation reduction obtain a benefit, but this benefit often comes with enhanced risk. The risk can be related to the validity of the position taken – gray area risk. Risk can also be related to necessary supporting documentation to sustain a position, even when the position itself is not controversial.

It is, of course, beneficial to quantify the reward when deciding how to manage incremental risk assumed to achieve reward. This helps with decisions to allocate resources, and to provide an explanation to management of anticipated costs necessary to achieve the benefit. One of the symposium companies which has been actively involved in structuring transactions so as to properly exclude trademark royalties from the dutiable value of import products, quantified the benefit in terms of improved operating margins. With the benefit clearly identified, a decision was made that gray area risk should be managed by anticipating questions from customs authorities. In anticipation of these requests, the company produced a defense package explaining the company’s position, and made this package available to each of the importing entities. Because valuation rules around trademark royalties are harmonized, this package provides support for the company’s position using World Customs Organization (WCO) Advisory Opinions, and published authorities from a variety of jurisdictions which have addressed similar situations. While the authority will not be dispositive of questions that may arise in any specific jurisdiction, it will provide a common platform for a well-reasoned, promptly delivered response.

Related Party Transactions

Related party transactions are estimated to constitute over one-third of international trade. Every company
represented at the symposium has related party transactions, and symposium participants were quick to point out that related party sales present additional customs risks in comparisons with transactions between unrelated parties.

There was, however, no consensus on additional steps, if any, that should be taken to address the risks. Participants noted that enforcement in this area has been inconsistent, and to some extent, lax in a number of jurisdictions. Consequently, as opposed to specific risk management activity that was tied to recognized reward in the valuation area, there was little emphasis on devoting resources to specifically addressing the additional risk created by related party pricing. “I lose sleep over the idea that tax can set transfer prices at a very high, macro level, whereas customs officials look at product lines,” noted one participant. “But we have not affirmatively addressed it.”

Some of the participants did believe that the interest of customs authorities in this area may be increasing, and anticipate additional scrutiny over valuation in the near future. Noting the recent cooperation between the Organisation for Economic Cooperation and Development (OECD) and the WCO, in discussion on the similarities and differences in income tax transfer pricing and customs valuation methodologies, one participant suggested that increased cooperation with tax departments will likely be necessary to manage related party valuation risk on an ongoing basis. Most participants are currently taking a “wait and see” approach before devoting additional resources to related party valuation risk management. Some participants characterized the approach as more “don’t look,” than “wait and see.” “Everybody is scared to turn over the rock and look under it.”

Summary of Key Findings

Managing risk by subject matter:

- Is particularly effective for subjects harmonized by WTO rules
- Allows for common data sets to be leveraged in multiple locations
- Is conducive to developing consistent approaches and positions regionally or globally
Auditing and Monitoring

Importance and Benefits of Auditing and Monitoring

Importers can mitigate global customs risks by assessing individual risk areas and implementing internal controls over import operations. Equally important, multinational traders have identified regular monitoring of the effectiveness of internal controls as essential to successful risk mitigation, and periodic independent audits as a leading practice.

Symposium participants concurred that auditing the effectiveness of internal controls over the import function is necessary, and conducted in-depth discussions to evaluate:

- Audit scope and approaches
- Audit teams
- Audit tools and implementation techniques
- Communicating audit results and ownership of compliance improvement steps

Participants described auditing and monitoring as critical steps toward drawing an accurate picture of import operations and compliance levels. As one executive noted, “The only way to find out what is going on is to test.” Others commented that audit activities enable their companies to identify and respond to changes in operations, internal resources, and customs laws. Another executive cited auditing as a means to benchmark processes, while identifying risks and opportunities along the way. Coupled with independent auditing, a pillar component of SAS 78, this two-tier testing of internal controls allows for continuous improvement to process and risk management.

Necessity of Corporate Sponsorship at Executive Level

The group also reached consensus on the necessity of high-level corporate sponsorship of import auditing and monitoring. The group’s position is consistent with the Control Environment element of SAS 78 — establishing and maintaining an operational environment that fosters compliance with customs rules and regulations. Some participants suggested that without executive buy-in, it is extremely difficult to properly execute import audit programs. Because an effective customs audit requires information and cooperation across departmental, facility and entity lines, an enterprise level corporate mandate is critical.

Defining the Audit Scope

Global Approach with Localization

Developing and implementing a comprehensive audit program that addresses location-specific risks is a leading practice. Defining the audit scope for global import activities can be challenging. Symposium participants formed consensus that certain risk areas and activities require global auditing consistency to be successful, while flexibility for local jurisdictional differences is imperative.

Subject matters noted by participants as necessitating global review on a regular basis and with a generally consistent approach included:

- Classification
- Valuation
- Country of origin
Subjects which required a primarily localized approach within the overall audit scope included:

- Free trade agreements
- Duty drawback
- Special regional preference programs, such as U.S. Goods Returned
- Basis of valuation relative to a jurisdiction’s use of FOB or CIF incoterm

**Prioritizing Audit Locations and Subject Matter**

Companies noted the complexity of prioritizing audits among geographic locations and subject matters, some prioritization always being required due to limited audit resources and activities spanning the globe. Most participants noted their consideration of multiple factors, both quantitative and qualitative, in prioritizing audit locations and subject matters for current review. Suggested considerations include:

- Locations with high transaction volumes (e.g., this could be evaluated by manufacturing location or import market)
- Locations with significant duty paid
- Locations with significant duty avoided (e.g., claims for preferential treatment)
- Transaction complexity
- Locations or subject matters identified in previous years as being problematic (e.g., errors identified, penalties issued, extensive customs inquiry)

**Globally Leveraging Regional Self-Assessment Programs**

Over half of the symposium participants are members of the U.S. Customs and Border Protection Importer Self-Assessment (ISA) Program, a corporate self-monitoring initiative providing benefits to businesses that demonstrate a system of internal controls based on SAS 78 and a documented audit trail from accounting records to customs entry records in order to match payments and expenses to entries. ISA members must have an assessment plan to fulfill the monitoring component of SAS 78, which guides continued testing of controls over customs compliance. Several participants from ISA-member companies noted their use of all or portions of the ISA framework in conducting audits across other regions. One company applies ISA concepts globally, and localized the framework to various countries.

Participating companies noted their utilization of various audit methods. All agreed on the importance of taking a multidimensional audit approach that incorporates quantitative and qualitative elements, including:

- Process Reviews—to evaluate the effectiveness of internal controls and identify process gaps that increase risks
- Transactional Reviews—using a limited judgmental sample focused on identified risk areas versus statistical sampling
- Systems Reviews—to drive data-level compliance on receipt, payment and valuation, and to test logic within the system itself
Audit Teams
Selecting the correct auditor to conduct global customs reviews was cited as important to audit scope and approach. Participants identified two critical characteristics of effective audit teams:

- Independence from the individuals actually undertaking the customs function
- Customs technical knowledge in order to adequately identify risks of exposure

Options identified as possible audit teams included:

- Corporate customs compliance office (independent of operational function)
- Corporate internal audit departments
- External customs consultants

Customs Compliance Office
Corporate customs compliance offices are often independent of the customs operations team and have the technical knowledge to conduct a meaningful review. Participants also noted, however, that these offices can be resource constrained. As a result, they may face difficulty completing the review.

Internal Audit Department
Special considerations were noted with regard to using corporate internal audit departments. Independence is a benefit of teaming with the internal audit department. However, participants agreed that it is extraordinarily difficult to identify risks or exposures unless internal auditors receive customs-technical training or hands-on instruction. One participant commented that internal audit initially resisted training, citing lack of time to audit the customs function due to its already full audit schedule. Persistence, over the course of a few years, enabled the participant to expand the training scope and obtain internal audit buy-in regarding the importance of customs audits. As another successful approach, one company hired an external customs consultant to attend initial site reviews with internal audit personnel, to train auditors on proper inquiries and issue spotting. This proved successful in getting internal audit a bit more up-to-speed on how to conduct a worthwhile review.

One company described a two-tier audit process implemented jointly by internal audit and its corporate customs compliance department. Under this process, internal audit personnel conduct an initial, high-level review to generally test the existence of and conformance with internal controls. Where a lack of internal control is identified, the customs compliance department conducts a deeper, technical review. Results of the technical review are then evaluated by the internal audit department. While this audit style is not completely independent, the structure allows the company to make the best use of internal resources and technical knowledge while maintaining some audit independence.

External Customs Consultants
Some companies reported using external customs consultants in whole or in part, to conduct reviews, noting that consultants are typically both independent of the customs function and possess the technical expertise required to conduct the assessment.

One executive noted its consideration of using an external auditor because of the large number of
international site visits required. Another participant identified two advantages to using external consultants: First, audits are sure to be completed because outside auditors don’t get paid until work is completed. Second, management perceives findings identified and articulated by outside parties as more credible. Collective agreement was reached that results delivered by external auditors receive a higher level of corporate attention.

Audit Tools and Implementation Techniques

Participant discussions centered on their experiences with a variety of global auditing tools. While the range of tools and their application varied, all participants agreed it is a leading practice to employ multiple tools and approaches in regular, periodic risk-based audits. A number of companies were able to leverage risk assessment tools for use during audits. Below are some of the tools identified as particularly valuable.

Questionnaires

Questionnaires are a valuable method to initiate monitoring activities. Many participants cited questionnaires as an essential tool to identify business and operational changes, identify compliance concerns, and evaluate risks. Questionnaires help companies identify areas for further review, frequently in preparation for site visits and/or interviews.

The length and scope of questionnaires varied depending on objectives, sophistication of local personnel, and to some degree, corporate culture. Several companies use customized, risk-based questionnaires. Another company created an internal tool based on CBP-developed questionnaires used to evaluate internal controls (such as the Focused Assessment or ISA questionnaires).

A different approach was to present a short list of questions (fewer than 20) to categorize corporate-wide risk by color coding high-, medium- and low-level risks. The questionnaire was rolled out to various business units around the world, and responses used to prioritize risks and communicate high level risks to senior management.

One company supplemented its initial questionnaire with a more detailed self-assessment containing country-specific appendices. This is used worldwide to evaluate internal controls and identify areas for transactional testing. The template also includes mechanisms for scoring results and reporting findings.

Site Visits and Interviews

Site visits are often necessary to verify the operational accuracy of questionnaire responses for high-risk locations and subjects. Some companies noted they conduct site visits or phone interviews specifically to validate questionnaire responses, while others cited these tools as methods of establishing deeper relationships with peers and partners.

Process Mapping

Process mapping is an exercise to create a formal flowchart view of all elements involved in the import process, from purchase order generation to accounts payable. Graphically depicting the import process across company locations, operating divisions, and business units makes it possible to identify areas needing improvement and opportunities to enhance the business processes.
Process mapping was identified as important to the risk assessment process. Confirming and updating process maps is a popular audit tool among participants. One participant commented that “...process maps help us find the interdependencies between groups. By process mapping you find the disconnects.” Members of the ISA program participating in the discussion agreed that “CBP loves maps.” Among companies using process mapping, several used internal personnel to process map (one company noted they use the corporate process improvement department), while some hired outside consultants. Many of the companies using process maps share their maps with other departments to improve communication and understanding. One noted it uses process maps as a tool, in conjunction with procedures and work instructions, to help inform third party providers.

While most agreed process maps are powerful tools for identifying gaps, a few raised concerns about the challenges of process mapping where operations are decentralized or managed by a third party. One person commented that it is very difficult to map processes if you don’t own the relationships with process owners.

**Peer Exchanges**

Participants were interested to hear of one company’s use of what it termed “peer exchanges,” in which colleagues in the customs function of different locations or business units were paired to review one another’s operations using an established internal review checklist. The participant noted this approach leads to increased knowledge-sharing within the customs function and ensures monitoring is conducted by individuals with customs expertise. While internal monitoring can sometimes cause intra-departmental tension, an effective checklist and careful pairing of individuals can make this a useful tool in the monitoring program.

**Monitoring Activities**

In addition to periodic auditing, regular monitoring is an important method of evaluating ongoing compliance. All participants believed that it is a leading practice to continually monitor ongoing customs operations and compliance. One company noted the importance of monitoring to identify procedural changes.

The group discussed areas that should be monitored. All participants agreed it is a leading practice to monitor the activities of customs brokers. A number of companies monitor discrepancies between customs entries and financials, either in specific locations or globally. One company described periodic review of the corporate general ledger to identify accounts that may capture costs related to customs.
Monitoring Tools

Auditing tools can also be used to conduct ongoing monitoring. Several companies described internally developed tools designed to identify exceptions to typical transactions and processes. Two companies described monitoring systems that identify discrepancies between data provided by the company to the broker and the data actually submitted to customs authorities by the broker. Errors are identified and sent back to the broker for correction.

Another company noted that, in the United States, it uses CBP Automated Commercial Environment (ACE) data to work by exception, identifying and resolving errors. One participant described a system which identifies incomplete entries prior to submission. The system automatically sends an e-mail to the vendor requesting the additional information required to complete the transaction.

One participant described a system designed to identify and prevent undesirable transactions. Each time such a transaction is isolated by the system, an exception report is generated and the transaction is stopped. This enables the company to prevent exceptions, instead of just identify them. Other participants noted similar systems for identifying and preventing exceptions; one participant described a similar exception-based process for monitoring classification. If a new classification is identified by the Enterprise Resource Planning (ERP) system, the entry associated with the classification cannot be filed until the product classification is reviewed. One participant summarized the value of monitoring exceptions by stating: “The purpose is twofold. It drives compliance and it allows us to increase productivity.”

One participant worked closely with corporate IT to create country-specific reports that can be downloaded directly from the ERP system. These reports are the basis for periodic monitoring of global operations.

Another company noted the tools and level of monitoring vary around the world, depending on the location. While some locations work hard to match specific data elements, others conduct more ad hoc monitoring. While several companies commented on their use of U.S. government-generated data as a basis for comparison, participants agreed that such data is rarely available from authorities outside the United States.

Participants also agreed it is a leading practice to have manuals documenting expectations of third-party service providers such as customs brokers.

Technology Used for Monitoring Activities

Participants discussed the value of using technology as a tool to help conduct monitoring. Everyone agreed that technology can be helpful, particularly in coping with resource constraints.

One participant noted that they use their ERP system for everything, and they work to integrate companies they acquire into the same system. The participant noted that U.S. Customs conducted a Focused Assessment several years ago, and was very satisfied with the established system data and controls after review of just one transaction.

Companies with large systems and high volumes stated they focus on validating the logic that governs the system since the volume precludes review of individual data elements. For example, one participant described a classification database containing millions...
of SKUs. The company reviews the system logic applied to identify the correct classification, instead of reviewing each classification. After discussing the challenges of monitoring systems with large amounts of data, the group agreed it is a leading practice to review systems logic as a part of ongoing monitoring and auditing processes.

While all participants relied on technology, in varying degrees to conduct monitoring, the group cautioned that its limitations should be understood as well. One participant warned, “Use technology to help conduct monitoring, but don’t rely on it.” Another participant pointed out that all systems have limitations users need to be aware of and actively manage. Several participants agreed that even the best systems will not help a company overcome bad data. One commented: “You have to focus on the process and controls in place to feed the systems. If you don’t have the data right, none of it will work.”

Communicating Findings and Ownership of Compliance Improvement Steps

Symposium participants discussed how results should be communicated to the customs function as well as corporate leadership. The group agreed on the importance of considering the interests and concerns of the audience when framing key customs issues.

Participants cited various methods of communicating findings, including written reports and presentations. Several found it easier to communicate findings by leveraging of existing tools. For example, one participant’s company creates a high-level summary report using internal audit’s template, to communicate results to personnel outside the customs department. This modified template has been well-received, in part, because the audience is familiar with its format. A more detailed findings report is provided to members of the customs function.

Two companies described online “issue tracker” tools used to report issues identified through auditing and monitoring. Each issue is individually identified, and tracked until it is resolved. Resolution is required within a set timeframe, and employee resolution of these issues is monitored. One company using such a tool noted one limitation: people tasked with developing the solution to the issue are typically those who were unable to resolve the issue in the first place.

Participants agreed that internal auditing and monitoring programs increase overall compliance within the customs function.

Many companies use customs audits as an opportunity to open dialogue with senior corporate executives and create visibility for their team. Several noted their findings are shared with operational heads. One company creates an executive summary of the customs audit, which is provided to executive leadership. The entire report, including this summary, is provided to members of the customs function. Another company has an annual review with the CEO, where audit findings are presented.

One company that has a centralized, corporate-wide audit committee commented that the opportunity to present audit findings to this committee raises awareness of the customs function. This participant
also uses the opportunity to demonstrate how customs opportunities can add value for the company.

One company acknowledged that audit results are leveraged to encourage top performance from employees. Audit results are formally built into performance metrics, and are, as a result, considered in performance evaluations. The participant noted this encourages employees to meet specific standards, and causes them to push their employees to meet these standards as well. Consequently, the requirements cascade through the organization.

Summary of Key Findings

- Audits should be conducted:
  - Regularly
  - With a consistent global approach
  - With localized audit plans

- Audit teams should:
  - Be independent from the customs function
  - Have customs technical knowledge

- Audits should examine:
  - Internal control processes
  - Sample transactions
  - Information systems

- Audits should be sponsored by corporate leadership who can drive cooperation, close gaps, and execute on opportunities

- Regular monitoring, in addition to periodic auditing, is important to effectively manage risk
Concluding Thoughts

Correlation with Corporate Risk Management

Risk management remains a primary objective of the corporate import function, and companies are increasingly undertaking efforts to proactively manage customs risks on a coordinated regional or global basis. We see a direct correlation between symposium findings on customs risks and overall corporate risk findings as reported in Ernst & Young’s Companies on Risk: The Benefits of Alignment. Matters generally concerning CEOs, CFOs, and Chief Risk Officers likewise concern customs executives as related to the import function. Similarity of goals, priorities and challenges exists.

- Two-thirds of CEOs, CFO, and Chief Risk Officers perceive a rise in risk levels over the last two to three years
  - Customs executives reported an increase in global customs risks. An increased awareness of these customs risks within their organizations is due to education efforts, government enforcement and audits.
- Forty-two percent of CEOs, CFO, and Chief Risk Officers believe they have gaps in risk coverage
  - Customs executives reported the existence of gaps in risk coverage often due to incomplete alignment with broader corporate goals and operations.
- Nearly 4 in 10 companies do not have formal processes to align risk management with corporate strategy
  - Customs executives reported lack of communication with certain business decision-makers and inconsistent involvement with larger corporate initiatives. One noted, “We have to manage risk in spite of corporate strategy.”
  - Further alignment is needed between risk management functions and line management, as well as across functions
    - Customs executives regularly balance competing interests of different functions, and are focused on further alignment with business functions.
  - Risk management challenges of the next three to five years include developing a more integrated and systematic approach, clarifying ownership of risk, and embedding a risk culture throughout the organization
    - Customs executives are particularly sensitive to dealing with multiple owners of differing risks, which requires clear communication of risk throughout the organization.

Key Factors to Successful Risk Management

A parallel also exists between corporate leadership views regarding the key factors to successful risk management and views expressed by customs executives regarding risk management vis-à-vis the import function. Both groups identified the following:

- Clear ownership of risk
- Understanding of risk throughout organization
- Internal mechanisms to communicate risk
- Integrated approach to risk management
- Documented risk management strategies
- Active senior management involvement
- Centralized approach to risk management
- Sufficient resources/investment
Customs executives were quick to highlight specific challenges that they face with regard to these key factors. They were particularly vocal about the need for resources and investment, giving definite views on the types of resources needed:

- Sufficient personnel and/or advisors with technical customs knowledge
- Adequate information systems or technology to obtain import data
- Identified local resources with ready access to regulatory content

They were also very focused on the complication faced in managing risks that can impact such a wide variety of departments and functions within the organization. There is no single owner of customs risk. This, in turn, makes it necessary to communicate with a variety of stakeholders, each with differing perspectives, goals, and interests. An integrated approach—with senior management sponsorship—is essential.

Commonalities of Leading Risk Management Practices

Effective customs risk management is an approach that aligns and supports overall business strategies, avoids duplication of efforts, and increases operational efficiencies. We extrapolated a set of leading internal control characteristics among symposium participants. They include:

- Ongoing risk assessment, recognizing the dynamics of business and laws
- Clear ownership of risk and communication throughout the organization

- Regularly scheduled independent audit of the customs function
- Technical expertise local to jurisdictions in which the company conducts importations, through internal resources and/or external consulting partners
- Focus on process versus compliance rate
- Thinking globally, acting locally: Globally oriented internal controls that embrace coordinated corporate-wide standards, yet respect and allow for interplay of unique laws, cultures, and operation

It is apparent to us that companies most successful at managing customs risks are dedicated to continuous improvement. They constantly reassess risks, and adapt internal processes, in light of dynamic business and regulatory environments. Even with robust procedures in place, a history of regulatory compliance, strong financial results, and operational efficiency, successful customs executives regularly challenge their own internal controls, working to:

- Focus on risks that matter most
- Waste less time, money, and effort
- Act on opportunities to gain competitive advantage
- Achieve growth and create value

It is interesting that this approach to proactive risk management has become commonly employed in an area that many businesses have historically viewed as a regulatory compliance function. The approach is a marked departure from a singular focus on regulatory compliance. In our view, the results are also very different. Achieving a high compliance rate remains an important objective. Those whose focus has progressed to proactive risk management can, in addition, contribute toward corporate growth and value.
Two Ernst & Young thought leadership documents are referenced frequently in this report and are available at www.ey.com.

Global Customs Best Practices, 2004 Symposium Report
This report summarizes the findings of an intensive two-day workshop held in New Orleans in May 2004 covering leading practices in the organization and governance of the corporate import function.

Companies on Risk: The Benefits of Alignment
This survey report is the second in a major research series that explores attitudes to risk and its management across key stakeholder groups: investors, senior executives, and audit committees.

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