

Government + Regulation

Building a Better Export Control Program

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How the right technology can keep exporters out of harm's way and in regulators' good graces

Due diligence is a term U.S. regulatory agencies use frequently to describe compliance practices that corporations must have in place when engaging in global trade. The mandatory checks and balances are fairly standard, and many global U.S. corporations are aware of them. But it's interesting to note only 62 percent of exporters surveyed in an October 2009 study by Management Dynamics have a full export compliance program in place. This leaves many companies vulnerable to risks in their supply chain.

Penalties and fines have been rising since 2006, with the implementation of the Patriot Act and the International Emergency Economic Powers Act in 2007.

Small to medium-sized enterprises have particular difficulty exercising compliance because of resource constraints. The lack of full-time compliance teams and introduction of new international markets can make compliance difficult, and often an obstacle.

The usual Catch-22 with export compliance is that additional checks in a supply chain will slow it down, creating bottlenecks and costly time delays, as well as the need for additional resources. Recent studies, however, show a compliance program with the assistance of emerging technologies can improve supply chain speed and beef up data integrity.

An export compliance program is a delivery mechanism for implementing export compliance standards and protocol within an organization and its supply chain. The key is to know the critical components to such a program and how automation can assist a small or medium-sized exporter in supporting its overall objective: minimizing risk and streamlining the supply chain while keeping operational costs at bay.

Implementing an export management program can be broken down into six components:

1. Showing management support

A compliance program's success begins and ends with the management team. As with most corporate policies, the support of the management team is critical in communicating objectives and making sure the rest of the organization understands its significance. If it's perceived the initiative isn't important, shortcuts are likely to be taken and trade policies not adhered to.

Three ways to show management buy-in:

-- Have a senior level manager address the company via e-mail or memorandum about your company's compliance objectives. Focus the message on personal responsibilities and point out a few recent fines and

penalties to make sure everyone understands the risk is real.

Schedule recurring meetings with the executive staff, such as a CFO or CIO, to brief them on the state of your compliance program to keep them abreast of all current topics and activities.

-- Create a compliance policy statement from the executive team detailing the program's objectives and employee expectations. Keep this document visible to all organizations. This will help sustain enforcement from management long after the initial program launch.

2. Company profile and risk assessment

Profiling your company for export risk measurements means understanding your distribution models and product lines. What you sell and ship and where it goes are factors in deriving risk.

Controlled items, particularly items controlled under International Traffic and Arms Regulations and by the Defense Department, are heavily regulated. If you know your products' export control number, you will have a pretty good idea if you're high risk or not. If most of your products are classified under EAR99 of the Commerce Department's export control list, then you have what are considered to be non-dual use items, or items that could not be used for destructive purposes.

In one of the most high-profile export violations to date, a company was recently fined \$100 million for shipping ITAR-controlled night-vision goggles to a variety of countries. The end-result is a massive fine, mandatory suspension of sales of the unlicensed product (\$20 million loss), and probationary status leading to major logistics bottlenecks and added expenditures.

Certain countries have been deemed higher risk for enhanced proliferation control initiative and diversionary risk concerns. Shipping to these countries often involves receiving certificates of conformity or diversionary risk certificates from the customers or partners you're shipping to. Over the past two years, the majority of significant violations have been due to exports to Iran and China.

The Department of Justice is a great reference for examples of U.S. Export Enforcement Prosecutions (see www.justice.gov/nsd/docs/summary-eaca.pdf).

Analyzing your sales and distribution channels is a good starting point to understanding your risk profile. Also, look at research and development and manufacturing facilities. Many fines have been imposed for the internal transfer of a controlled product to a high-risk region even though the facility may be within the organizational structure.

The nature of the end-user will usually dictate the use of the item. Companies that ship to military or government entities should exercise greater care in finding out what the "end-use" of the product will be. This includes knowing whom the final end-user of the product will be and in what capacity it will be used. Shipping to a party that then re-exports the product still leaves the U.S. exporter responsible. Investigate the end-use to ensure the product is not sent elsewhere.

Exporters that ship to governments or military-oriented organizations need to exercise a higher level of due diligence given the nature of the end-users. End-users that engage in nuclear, chemical, biological, or rocket system development should be heavily monitored.

3. Cross-organization accountability

Accountability from every organization is imperative to the success of an export compliance program. One illegal shipment can put a company in noncompliance, so it is important that all resources touching the international supply chain are aware of their responsibilities. This includes sales teams, customer service, logistics/transportation, finance/accounts receivable, research and development, human resources, information technology, legal counsel and purchasing.

Tailor the message for each team so it resonates with its own processes. This will help create accountability within

each team if they understand exactly how they can help create a more compliant program and the associated risks if they don't. Examples of good tools to instill accountability are:

- Hold knowledge transfer sessions to discuss the export program and how it will impact and benefit the company.
- Distribute FAQ documents regarding the company's compliance requirements.
- Include a section about export compliance in your company's employee handbook.

4. Automated compliance process control

Compliance processes are the tasks and protocols used to implement an export compliance program on a day-to-day basis with respect to the supply chain. Compliance checks need to be in place and executed for all international shipments in order to achieve strong control and consistency. The following processes focus on the regulatory requirements of each major compliance task.

Trade content: Understanding and access to the trade regulations should be considered the "meat" to your entire operation. If you don't have this correct, you're missing critical data that helps safeguard your company from negligence.

This is an ongoing process for new products and existing products alike. Knowing when new products have been created in your warehouse or sold for international commerce is necessary to stay on top of your classification tasks.

Be aware of content updates and their impact to your supply chain. A best practice is to use automated software to synchronize changes — on a daily basis — so your process is always in compliance. The updates can trigger notifications to key compliance users informing them of what changed. Many software solutions also can subsequently identify how many orders it will affect by searching shipment data for invalid HS and ECN numbers, post-update. Corrective action can then be taken to reclassify parts requiring it.

Small and medium-sized enterprises that are growing through acquisitions or launching new product lines will find themselves with spikes in classification work when new products are introduced for sale. Integrated software supports growth initiatives by ensuring all products are run through a central point of validation.

Using software to store classification details is a best practice, which gives a company a defined process to manage the work associated with classification, record all necessary audit data when information changes, and also use personal productivity tools such as Microsoft Excel to export the data to third parties.

Advanced features available in only certain software packages will allow a company to efficiently integrate third parties with their compliance process. The use of a "portal" technology allows a company to extend their compliance process to third parties such as brokers and forwarders. Access should be security controlled to provide only the limited amount of access required, and provide an audit trail to record all major actions taken by third parties and internal users.

Export screening: Export screening is the process of determining whether a company needs a license to ship a product, focusing on two key questions. What is being shipped? And where is it going?

If one of your products requires an export control number other than a classification of EAR99, this product should be monitored and all shipments of this product should be screened for license requirements. If the product could presumably be sold anywhere in the world, there likely will be scenarios that will require you to obtain a license prior to shipping. All ECN codes have at least one reason for control.

The other factor in determining a license requirement is the location of your customer or any intermediary destinations. The country (or countries) of destination has an associated country chart record with identical reasons for control potential, just as the export control number does.

Determining export license requirements can be straightforward, but requires a collection of data to analyze

the scenario. This data could be dispersed in a few places depending on the sophistication of your compliance processes and supporting technologies.

Software can take the guesswork out of making the license determination, and it speeds up the process. Software solutions can automatically pick up the correct ECN from a part classification database and apply the reason for control using integrated trade content to determine if a license is required. Export screening utilizes data from the transaction to create the scenario, and then automated processing to decipher if a license is needed.

Although parts with an ECN classification can require a license, they often don't and can be processed as "No License Required." The ability to automate these decisions is critical to freeing up valuable resource time to focus on other activities. Manually performing this task can lead to a bottleneck in the shipment process if the decision is not made fast enough.

Documentation management: Documents are the final step of an export cycle. By creating documents, you're indicating the transaction is ready to ship and has undergone and passed all necessary compliance screening. Documentation is another area of export compliance management that can help expedite your shipping processes.

Creating documents can be a time-consuming task. If done manually, it involves rekeying shipment details into a form, which could take a long time — more than 30 minutes in some cases.

A great way to expedite document creation is to use pre-existing shipment information to automatically fill in the document template. This will require the majority of data to be in one place, and a software tool that can auto-map that shipment data to pre-existing fields in a form.

Many export software packages offer a document generation system that integrates with their export compliance software to create documents. Companies using software can often create their documents in a minute or less, enforce screening approval prior to document creation, and include diversionary risk statements on all documents to ensure legal communication downstream to its recipients.

5. Communication and training

Once compliance processes have been developed and the appropriate responsibilities assigned, it's time to train teams and individuals in the organization.

Training for individuals in the organization helps drive awareness and accountability, but also teaches employees what to do in certain situations. All teams and individuals expected to execute compliance management tasks or touch the export process should attend a training session.

Tailored training sessions should be held for each team responsible for a compliance process and should focus on addressing these questions for each task:

Business case: Why do we do this, and what risks are we mitigating?

Compliance task: How do we execute the task, and who are the responsible parties?

Escalation procedure: If the task can't be completed or needs to be escalated, who should be notified, and in what timeframe?

After initial training, employees should have regular recertification training. New employees should be trained as soon as possible. This is up to each company, but best practices suggest retraining once a year.

Other factors to consider when determining frequency of retraining are complexity of export operations, employee turnover rate, changes in the Export Administration Regulations and company compliance policies (immediate retraining) and changes in company product lines.

Training is often done in-house by an organization's compliance team. Employees also can be sent to third-party consultants for training, but this can be expensive and not tailored to a company's specific processes. Internally

developed and tailored training programs are considered a best practice.

6. Audit and assessment

Continuous audit and archive is a compliance program staple. Audit trails record key events during the compliance processes. This can include key decisions and status changes, such as an HS classification or a transaction flagged for a license requirement.

The person who performed the event or decision and the date and time it happened are equally important. It creates an accountable trail of compliance activity and provides a historical path so a company can backtrack later in time. It's also a major Customs audit check box.

The record-keeping requirements for U.S. exporters can be found in Section 762 of the Export Administration Regulations. It describes what you need to retain, requirements for producing audit records, format requirements and retention periods. When dealing with third parties such as brokers or forwarders, language around record retention should be defined clearly in the contractual agreement for services.

Assessment and diagnostic reporting of your compliance process is an advanced procedure that will attest to positive gains from having an export compliance program. These are valuable reports that will help during an audit by Homeland Security or Customs, and even your own management team. Some examples of diagnostic reports for compliance programs are:

- Report to measure decision-making across teams or individuals to assess large resource allocation for particular processes. Knowing who is executing your compliance processes is an important metric to be aware of.
- Measuring time to closure is a valuable metric to demonstrate proactive resolution procedures. The lower the closure time, the stronger your compliance program and the faster your supply chain. Executive management will look favorably upon this metric because it shows productivity gains.
- Assessing management commitment is also useful to gauge resource allocation within the company. Has the program had sufficient resource time from other supporting departments?

Obviously, just being able to reference these types of metrics demonstrates centralized top-down awareness of the overall program.

Diagnostic reporting is difficult to achieve without a centralized solution that can track and reference all key events, resources responsible and dates of execution. Leading export management solutions provide performance management reporting and allow for customized reports tailored for each company.

Companies that have established an export compliance program can garner further benefits by looking at other avenues to streamline their supply chains using compliance process enhancements, including electronic filing and use of trade portals.

Many exporters use their forwarder to file their electronic exporter information with the Automated Export System. The recently revised regulations require all EEI filings to be made electronically using AES; paper shipper's export declarations and documents no longer are accepted. The EEI requires some additional data elements that would be required for a normal export screening.

Most of the information is available and known to the exporter. So why doesn't the exporter file on his own? Filings can cost more than \$20 per transaction, sometimes as high as \$70. Even in mid-market environments, this will become expensive and an operational cost that can be reduced. Self-filing is an Export Management 2.0 initiative by which an exporter can utilize export management software to aggregate key data and perform the filing on his own.

Collaboration between third parties in a supply chain increases productivity and improves data integrity. Trade portals allow third parties to access relevant business data within an export solution, allowing them to provide data

to the exporter or gather data to assist in moving a future process along, thereby streamlining the supply chain. Some examples of portal uses:

Freight forwarders: Portal access to provide key shipment and vessel information that the exporter can use for self-filing.

Brokers: Portal access to provide classification details for new product lines and obtain existing HS classification information to support entry filings.

Suppliers: Portal access to provide country of origin and preferential status for purchased parts.

Portals are a next-generation tool in supply chain systems and shouldn't be overlooked in trade compliance either. Most third parties will welcome the initiative because it benefits them as well.

Today's economic environment offers companies an opportunity to take advantage of many more markets than previously available. It has become essential for companies to reach out to foreign markets in an effort to build revenue streams and larger profit margins. In doing so, complexities with export regulations will arise and, without the proper infrastructure, can prove to be an impediment to the supply chain and security models of most companies.

With an export compliance program, companies can begin to control their export process in a more controlled and secure manner. ECPs allow companies to streamline their regulatory checks by ensuring all processes are followed, key members are held accountable and the entire cycle is auditable and monitored.

Automation through software is a leading mechanism to help support such an initiative. By automating screening, centralizing data repositories, and providing enhanced data collaboration with third parties, software not only can enhance the security of the supply chain, but also lead to efficiency gains.

Export regulations apply to all international shippers and are being enforced now more than ever. Automating your export process will secure your company's supply chain and prepare your company for the ever-changing global marketplace.

Nathan Pieri is senior vice president for marketing and product management at Management Dynamics. This article was adapted from his white paper entitled "Building an Export Compliance Program: Critical Elements for Leveraging Automation to Support and ECP."