

Overcoming Obstacles to Effective Compliance Programs

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1. Goals of a Program: Why Do It?

- a. Provide Legal Protection
- b. General Obligation - Good Citizenship
- c. Often Reveals Duty Savings/Logistic Solutions
Solving Compliance Problems Often Solves Others
(Communication) (Accounting)
- d. To Overcome Routine Obstacles
(expect obstacles/prepare for them)

2. How to do it - An Overview

- a. Diagnostic
- b. Development
- c. Implementation
- d. Follow Through/Maintenance

3. Overcoming Common Obstacles

- a. 1: Limits: Everyone is asked to do more with less
BUDGETS \$\$\$\$
Other Resources
- b. 2: Tendency to view as administrative, not legal
- c. 3: Tendency to "commoditize" the project
- d. 4: Corporate Structure Prevents Internal Communication
- e. 5: Complacency - follow through - commitment.
- f. 6: Broker Reliance
- g. 7. Culture
- h. 8. Traditions
- i. 9. Structural

4. Practical Considerations

**OVERCOMING OBSTACLES TO
EFFECTIVE COMPLIANCE PROGRAMS**

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Part 1 - Goals of a Program: Why Do It?

When I am working with a reluctant company, or even one that just wants good reasons for everything they do, I always point to at least three reasons to establish a compliance program. Since compliance is often viewed as a luxury, we are often called on to convince or persuade corporate decision makers to develop a program. The easiest companies to convince -- and often they need little persuasion -- are those under investigation or subject to close scrutiny by Customs. Once a company is in this posture, the only common obstacle is time; other obstacles seem to evaporate under the pressure. So, setting aside a situation in which a company is using a compliance program to mitigate penalties related to a violation that has already occurred, what are the three reasons for an importer to upgrade or create a compliance program?

Reason #1 - Protect the Company

This is the number one reason because since the Mod Act importers are obligated to exercise "reasonable care." I know that others are going to talk about this concept and I would be happy to explore it with you in questions, but my point about reasonable care is that you must look at the conduct/system in hindsight. It may be difficult to ponder what reasonable care is when working at a situation looking prospectively, i.e., an upcoming shipment of chemicals from Korea, but Customs rarely looks at it that way. The way it comes up is later, when there is a problem discovered with a past shipment. Then, Customs is looking back at the importer's conduct with knowledge of a violation -- a false statement or some other issue. When Customs looks back with knowledge, the standard is different. Hindsight is always 20/20. What will Customs deem to be satisfactory for a company to have done? When mistakes do occur, as they inevitably do, what is the story that you will want to tell? The one I believe is most effective is that the importer has a compliance system in place which catches most things, and here is the key, constitutes reasonable care, but could not have or just was not able to catch the particular mistake discovered in this instance.

While one cannot always equate a compliance program with exercise reasonable care, putting a program in place goes a long way toward that goal. The important question is what sort of compliance program. We can talk about this later and I will define what I mean by an effective program, but remember that it will not protect the company if it is not credible. To be credible it must not only be structured correctly, it must be followed. This is a tough test.

Reason # 2 - Save Money

I know, how can you save money when you have to spend money to establish a compliance program? Well, first of all, consider the cost of a compliance program as an investment in which you measure the return by what you do not have to pay to Customs. This number may be hard to quantify, but believe me, it is very real.

You also can save money by discovering ways to eliminate or reduce duties that you are now paying. Even seemingly sophisticated importers often discover new opportunities to save on duties. There is no substitute for a thorough functional understanding of any company's importing operations, and no better way to obtain that through the process of setting up an effective compliance program. You will gain insights on the business of the company and see things that were hidden or never examined before.

You also save money in some cases by eliminating needless or wasteful existing internal procedures. Streamlining the communication and coordination of the Customs function can often lead to direct and immediate action, which cuts costs. For instance, we have seen a compliance initiative identify redundant or unnecessary layers of bureaucracy involved: multiple forwarders, multiple brokers, consultants, supply, purchasing, etc. that may provide opportunities for cost saving. Logistic bottlenecks or circuitous administration are laid bare.

Reason # 3 - Solve Other Problems

Seems odd, to establish a compliance program to solve other problems in the company, but consider for a moment whether you have ever set out to fix something and along the way you found something else that was broken (like tying a shoe and the lace breaks!). A Customs compliance program can lead you to identify and solve other problems. This is simply because to do a program right, you must deal with many different aspects of the company's operations. You will deal with accounting, shipping and receiving, purchasing, MIS, etc. As you develop systems and procedures to enhance coordination and communication among these various components, you will inevitably find other things that are broken, and hence the opportunity to fix other problems.

Part 2 - How to do it - An Overview

Step 1 - Diagnostic Review

The first step is to become familiar with a company's existing Customs procedures. The term diagnosis has a medical ring to it, and I use it on purpose. Evaluating the "health" of a company's systems, from a compliance perspective, is exactly what should be involved. Many of these procedures are no doubt sufficient; some will not be sufficient. Other systems that are needed may not be in place. Accordingly, the first step in determining what needs to be done to get to point B -- compliance -- is to locate point A. How far away are the two? We always start with a customized set of questions to begin to gather the information needed to perform the diagnosis. The questions are based in large part on the informed compliance materials distributed by Customs. As a practical matter, this process involves meetings, interviews, review of data, and other activities.

Step 2 - Design and Development

With the information gathered in stage 1, decisions can be made about the most important issues. If a voluntary disclosure is warranted, it can be made. You can then turn to the important compliance questions about the most effective structure: a balance must be struck between procedures that promote compliance and those that facilitate the smooth conduct of business. The design phase will draw the specific line from point A to point B and will identify the specific documents, systems, procedures, and techniques that need to be created. Production of these elements can be scheduled and examples selected. During this stage, we draw on the informed compliance materials available from Customs, and previous compliance programs we have done, including recent efforts under the Customs Modernization Act.

Step 3 - Implementation

The implementation stage is where most of the paperwork and integration of systems takes place. The initial design very often gets modified as unforeseen obstacles or relationships emerge and new or revised procedures are needed. As the program addresses the major elements of compliance -- gathering and reporting information on value, classification, and origin -- overlapping systems will be

identified, unconnected procedures will be revealed, and missing information will be uncovered. The implementation phase is very "labor intensive" and requires switching back and forth between a focus on the compliance "forest" and the "trees" represented by the specific procedures. Shifting back and forth is awkward, but needed to ensure not only that each procedure or system works, but that they all fit together and work to achieve the ultimate goal.

Once a program is implemented, it should be tested to see if it withstands scrutiny. The best way to measure it is to conduct a mini-review or internal audit.

Step 4 - Follow Through/Maintenance

The final stage really never ends. It includes additional periodic testing and evaluation, but also includes ongoing training and education, revision of procedures as business changes, adapting to new Customs laws and regulations, and in general preserving the vitality of the compliance program.

Part 3 - Overcoming Common Obstacles

There are at least ten (10) common obstacles to get over if an effective Customs compliance program is your goal. There is no magic to the ones listed here, but they are the ones that I see most often.

Obstacle 1 - The Budget

This is always the number one problem. Resources are becoming tighter, especially now, when everyone is called on to do more with less. I put this problem first precisely because it is the toughest and resists easy solutions. The fact is that many budgets are reactive animals that get allocated when need is most urgent (if we don't do this some horrible thing will happen). The problem is also that budgets are short term. Many do not think that failing to have a compliance program is necessarily so bad. This is short term thinking, of course. Looking at it beyond the immediate budget period, one must recognize that dollars invested in compliance will yield long term dividends.

Approach: I approach a tough budget armed with several things. First, I have a good understanding of what the problems are that are facing a company.

This is a must. If you know this, you will only propose compliance procedures that are necessary. Second, propose realistic and if necessary, staged, remedies. Do not propose "a comprehensive, complete, and definitive program." There are no "A"s in the compliance business, there is only pass fail. Either the program works to help the company exercise reasonable care or it doesn't. There shouldn't be any other standard to judge by. If you know what really needs to be done and you propose realistic solutions, the last step is to provide some incentive. What I do is provide the decision maker with publicity about actions taken by Customs. The size of penalties and the problems that failure to comply give rise to are often convincing. In addition, what an importer's peers are doing can often be very persuasive.

Obstacle 2 - Underestimation

A common obstacle that is encountered is the tendency to characterize compliance as an administrative or low level function. This occurs both in underestimating the importance of Customs to the Company, and a tendency to undervalue compliance itself. These tendencies are obstacles because they cause the company decision makers to view the project as unimportant and insignificant. A Customs auditor once told me that when he would visit a company he asked about the most senior person responsible for Customs matters. You can guess the answer at most companies. Then he would ask about the most senior person responsible for taxes. You can also guess that someone more senior was involved in dealing with the IRS. He would just let the obvious difference in treatment sink in on the assembled company representatives. You can imagine how far behind the company would then begin the audit.

Approach: When faced with an underestimation of the role of the Customs function, we often hold up a mirror and reflect back the differential treatment. Based on some preliminary diagnostic review, we often identify the importance of imports to the company's overall operations, and attempt to quantify the impact on operations if imports were delayed or if the company's ability to import were affected. This will usually help move the project along. We also pull out specific experiences -- such as mistakes that were made that were never caught by Customs (I know, these are pretty rare) -- and show what could have happened if Customs had discovered them: possible duty and penalty exposure. We then develop a hypothetical description of how the event would have occurred if an effective compliance program were in place. What would have happened if there was a powerful compliance officer that could stop transactions before they

resulted in a violation? This may not carry the day, but it often focuses the conversation on the right subject.

Obstacle 3 - Commoditization

This obstacle has a Washington bureaucratic ring to it. What it means is that many corporate decision makers believe that compliance programs are "off the shelf" commodity projects. One program is interchangeable with another and no special or customized features are needed. They are encouraged in this view by those who peddle "one size fits all" programs. This tendency is an obstacle because it limits the scope of the project. Decision makers, thinking they know best, circumscribe the scope of the project and authorize only the most limited budget and give the project very little authority. This dooms it to failure. There is one axiom of compliance programs: a bad compliance program is worse than none at all. If all that is possible is an off the shelf, commodity program, you may as well not start. Better to continue to work through the obstacles to get to the point of having some meaningful procedures.

Approach: When faced with this obstacle, you have some choices. If you have the luxury of time (or if you know the initial decision is unchallengeable, which we have encountered), one approach is to say, "Okay, let's see what the product looks like." The company buys the "commodity" manual. We then take a look at it. We have seen some that are fill in the blank programs that offer very little to a company in the way of a compliance system. The manual can be taken off the shelf once in a while and waved around, but it doesn't work. Customs might even be initially satisfied, but when Customs begins to review the company's actual importing operation, they will quickly see the gap between the paper and the reality. Under this approach, the shortcomings of the commodity program often demonstrate the need for a real program. Another approach is to explain how much harm such a program can do. It lulls the company management into thinking that a problem has been solved. This plants the seeds for all sorts of management problems to occur because business goes on but no real steps have been taken.

Obstacle 4 - Corporations

Modern corporate structure is often itself an obstacle. With the constant emphasis on downsizing, right sizing, and all the other sizings, each department is often internally focused, trying to meet benchmarks or standards of performance

for their department. Since an effective Customs compliance program requires effective communication across department lines -- accounting must talk to operations must talk to purchasing and so on -- the structure itself can be an obstacle. This, combined with the tendency to underestimate the project, can be difficult to overcome.

Approach: In many cases, a new structure within the corporation -- i.e. the function of Customs compliance -- must be created to have an effective compliance program. How can this occur? The only way that I have ever seen through this problem is to focus on the business. When stumped by the corporate structure, I go back to basics. What is the company's purpose: to sell product. To sell it, it must import it. To import it, the company must have some measure of compliance. Creative solutions are needed in some cases. If the company is decentralized, then an overlay with connections can be created in and around the structure. If it is centralized, the task may be easier but in most cases the solution will be found in the business. One thing is clear: a program that works against the business will never succeed. Finding the solution in a particular case will come out of this understanding.

Obstacle 5 - Broker Reliance

An obstacle we often face is that companies will defer or delay implementing compliance programs because of their reliance on brokers. Many companies that have not undertaken revision of their programs tend to rely extensively on brokers. Now brokers are important and crucial, but if the broker thinks the importer is responsible for exercising care and the importer thinks the broker is, neither is likely to be doing it. From a legal standpoint, a broker cannot exercise reasonable care unless it is also the importer. The importer is the one charged with reasonable care. Relying on the broker is therefore misplaced. Brokers can do a lot, but they cannot do what importers alone are charged with.

Approach: Reasonable care and informal compliance require establishing a new partnership with your broker(s). Develop an integrated system that divides the relative responsibilities between the importer and the broker and develop procedures to take advantage of all of the expertise the broker has to offer (but also carefully monitor the brokers performance on your behalf: remember, you are responsible for what they do).

Obstacle 6 - Complacency

This obstacle is insidious. It sneaks up on companies and gathers strength when they are not looking. When a company goes along for some period of time and Customs doesn't come calling -- either an audit or some other way -- many companies figure they have dodged a bullet, and they relax. This creates an obstacle because companies tend to project the future based on their past. If they have been lucky in the past then they expect to be lucky in the future.

Approach: The difficulty with this obstacle is that some companies never do see Customs. They go along for years and their problems are never discovered. What is more, many companies are well aware of the limited resources that Customs has available for audit and enforcement cases. They continue to play the odds. True gamblers are best left to the poker tables; they will not be interested in compliance anyway. This is not true of most companies, and if they see that their strategy is really a bet, they often will undertake compliance as an alternative. To help companies see this, we have often relied upon the techniques discussed earlier to motivate companies in the first instance: peer comparison, duty savings, penalty avoidance, and others.

Obstacle 7 - Culture

I often find that "corporate culture" can play a role in facilitating or impeding the development of a compliance program. This occurs in two ways: in the case of many foreign corporations doing business in the US -- and especially when it comes to integrating a related foreign supplier into the program. It is also true of non-foreign companies. Those unfamiliar with U.S. regulatory procedures and systems often hesitate about compliance. In other cases, we have found remarkable cooperation in the diagnostic stage of program development, and perhaps even good cooperation in the development and design stage. When it comes to implementation, however, and roles and functions must change, we run into a brick wall. Individuals will resist change and will attempt to preserve their empires. In some cases, there is nothing at stake more than simply controlling information, which of course can be a source of power in a corporation. Those not familiar with US legal practices, whether they are foreign corporations or new importers not familiar with regulation, are most commonly those where culture plays a role.

Approach: There is no substitute in any compliance program for top down instructions and leadership. The most senior levels of management must get

behind the program and the individuals running it and place it above cultural issues of all kinds. This will give those attempting to establish the program the leverage they need to get it done. Without senior management support very little can be done to overcome cultural obstacles. If the support of senior management is not present, you must go back to the beginning of the process, and take on the issues I addressed earlier, why do it.

Obstacle 8 - Traditions

This obstacle may seem to overlap with culture, but I separate it because I find it very often as a distinct obstacle, and one which more often arises at companies that have been importing for many years. In these companies, patterns of behavior have built up, an absence of intervention by Customs has led to unconscious acceptance of the way of doing things. Tradition is such an obstacle because the old way of doing things, pre-Mod Act, won't work anymore. Since that way worked for so long, however, many tend to fall back on it. They either do not realize or want to avoid the fact that new functions are required under the Mod Act. The importer must do everything different. To individuals within a company -- and even their consultants in some cases -- that have had good success over the years with Customs, the new compliance process is viewed as somehow a nuisance; they know how Customs works and how to get things done. When I discover that this obstacle exists at a company, I realize we have our work cut out for us.

Approach: Overcoming traditions is difficult. Telling management that a new system is needed often creates rifts in the company. On the one hand, you have the "old timers" that feel they know what they are doing, and on the other you have those listening more closely to Customs who are arguing for something new. Those advocating change often have little credibility. Accordingly, something is needed to strengthen the hand of those pushing change. I use everything that I can. Customs has released lots of useful information, much of which makes the case very well. The video, "Customs Compliance: Why You Should Care" is great, if you can get folks to watch it. The fact that the reasonable care checklist was released by the Penalties Branch can also get attention. The fact that you have a clear and consistent message coming from Customs is big help. Overcoming tradition is going to be a company-specific strategy that will take some doing.

Obstacle 9 - Turnover

A major obstacle is key employee turnover. If a company starts the process of establishing a compliance program but does not fully support it, the person charged with the responsibility can be alienated and depart. This obviously is a big set back. In other cases, key employees just move in to new or different opportunities.

Approach: Retention is a problem in many areas. From a compliance perspective, management buy in is absolutely critical. Because those responsible for compliance must make difficult -- and often aggravating -- decisions, they must have the backing of management. In addition, this further points out the need to have some support from others: the Customs function cannot reside in one person.

Obstacle 10 - Ownership

Compliance is sometimes an alien concept for companies. They are intimidated or overwhelmed by the jargon and the details. In some cases, people are just too busy. In these sets of cases no one has ownership, either because they do not want to take it on, or because they do, but are not committed to it. This is an obstacle because if no one takes ownership, the program will inevitably fail.

Approach: In many cases, someone in the company is interested or prepared to take ownership, but the institutional support is not present. In these instances, once the decision is made, the corporate energy carries through. One indication of corporate commitment and of creating ownership, is to create a new position, in which one or more persons receive new responsibilities, and even a promotion. If companies are not willing to create a new position for something as important as Customs, then of course ownership doesn't matter. We try to approach this problem as part of the tradition obstacle: the new obligations under the Mod Act create the need for the new position, since it really is a new function.

Part 4 - Practical Considerations

In the final portion of my talk I would like to briefly address some practical issues. If you have stayed with me this far, then you are probably more aware of the obstacles to developing an effective program than you were before. I hope I haven't dampened your optimism too much.

Priorities

Start with important issues. You cannot always set out to create an entire Customs compliance program all at once. You must be selective, and tackle your most important issues first. Find out through the diagnostic process what issues most threaten your company and what the most difficult obstacles are. Set up a sequential or staged process in which you put procedures in place and correct the most important issues. In some companies, this is valuation. In others it is classification. Pick your target and do what is manageable.

Patience

This is one of my biggest weakness, I have to admit. Once I get started on a program, I am very anxious to get it done. I sometimes forget that compliance is a journey, not a destination. Results cannot be achieved overnight. Do not allow others in the company to set unrealistic deadlines or to exaggerate expectations. You must develop a reasonable schedule and stick to it.

Resources

Remember to use all resources available to you. This may seem obvious, but we have often found that those responsible for establishing a program in a company are too narrowly focused on what resources are available. For instance, a good compliance manager will have the assistance not only of someone skilled in compliance matters, but will have support from the broker(s), accounting firm, lawyers, and others. Many companies have other parts of their business heavily regulated (such as environmental or SEC) and there may be folks in those areas that can help. They will have had to take on some of the obstacles that you will face, and you never know, you may find some answers. At least you will find a sympathetic ear.

Expect and Welcome Obstacles

It's more fun if you expect obstacles. Try not to see them as obstacles, but as opportunities. I know it is a cliché, but since compliance is a process the path is defined by the encounters. The path of compliance is a path of meeting and overcoming obstacles. You may never eliminate them all, but you will, by taking them on, begin to manage the process of compliance. This is the goal.

Don't Expect Miracles

Finally, remember that perfection is not possible. No program will be complete, easy, smooth, or fast. Experiment with procedures. Try new ways of communicating. Trial and error is a good method. Miracles just don't happen here. Compliance is a labor intensive ongoing process. Keep your expectations in check and you will have greater success.

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