

Global Data Mining, LLC

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# **The New Normal**

*Import Compliance & the Forces of Change*

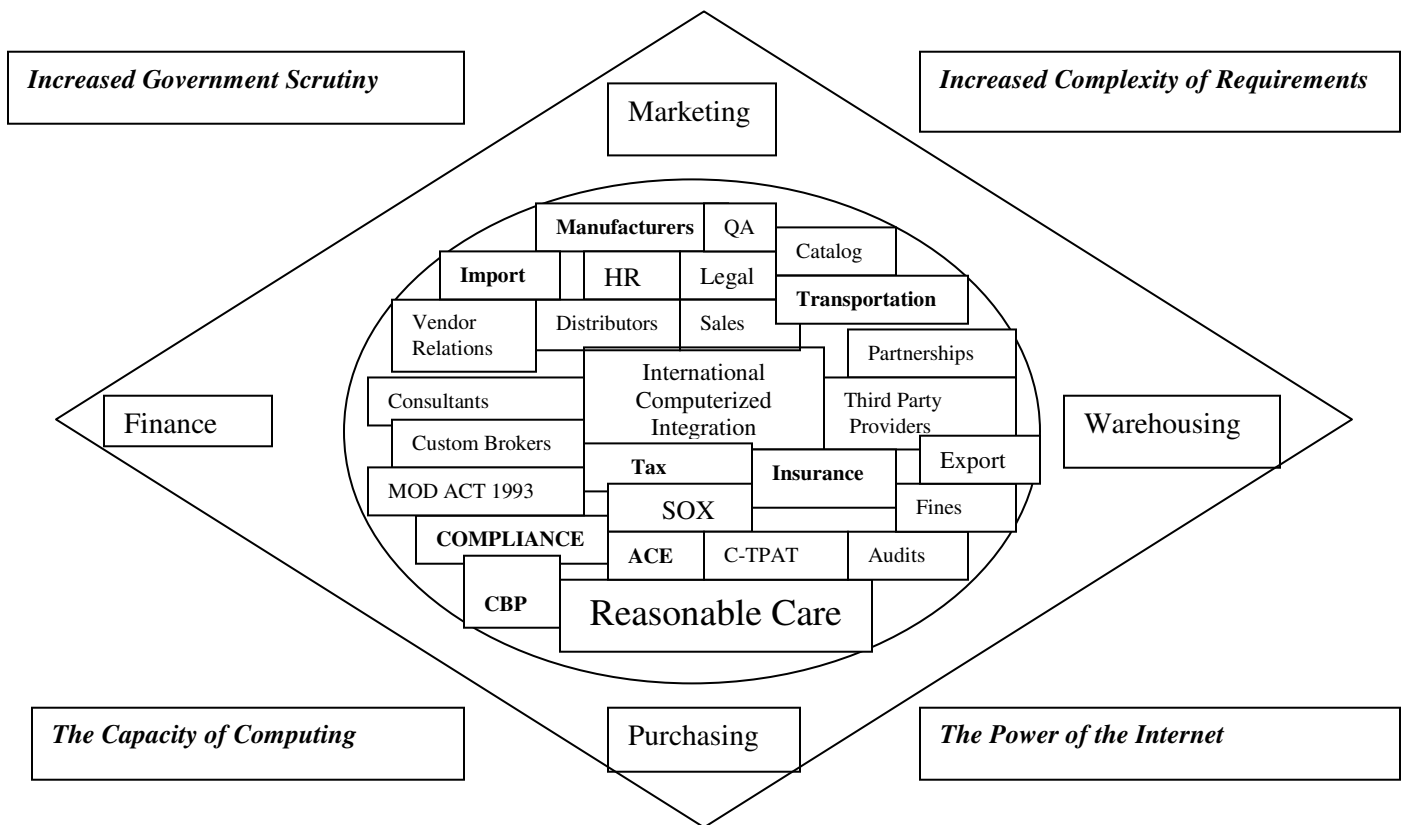
**WHITE PAPER ON U. S. CUSTOMS COMPLIANCE IN THE 21<sup>ST</sup> CENTURY**

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## Executive Introduction

- Has your company's importing activities increased over the last decade?
- Have you documented internal processes to control communication and assure compliance even with 3<sup>rd</sup> party companies or brokers handling your imported products?
- Have you demonstrated **REASONABLE CARE** in accordance with the Modernization Act of 1993?
- Have you improved the transparency and accuracy of your International accounting and record keeping in accordance with **SARBANES-OXLEY ACT OF 2002 (SOX)**
- Are you in Position to respond to the **AUTOMATED COMMERCIAL ENVIRONMENT (ACE)**
- Are your import processes keeping pace with the four major forces of change impacting U.S importers of the 21<sup>st</sup> Century: Increased Government Scrutiny, Increased Complexity of Requirements, The Capacity of Computing and The Power of the Internet?
- Do you have a single person at your company who has direct and regular access to the CEO and CFO to inform them of logistics and trade related risks and issues?



If you are a person directly or ultimately charged with financial or import compliance, documentation or one of the multitudes of functions of international business this white paper is **A MUST READ**.

This paper explores the many important questions that confront importers in the 21<sup>st</sup> Century. You will learn there are risks, rewards and penalties in today's global market and you will need to tread carefully, **for non-compliance in the future is not a viable option.**

President Bush's Fiscal Year (FY) 2006 budget recognizes that securing America's borders is a top priority. Accordingly, U.S. Customs and Border Protection (CBP) received a 4.8% budget increase -- one of the highest in government. Specifically, the FY2006 budget for CBP totals \$6.7 billion. How much are you investing to assure the compliance, accuracy and transparency of your international transactions?

It is said that current CBP computer and communication systems are based on technology that is over 20 years old. This is why \$305.5 million in ACE funding and \$16.2 million in International Trade Data System funding has been flagged for CBP's trade management systems. The intent is to enhance business processes that are essential to securing U.S. borders from terrorists by providing the intelligence required to target illicit goods, while ensuring the efficient processing of legitimate trade. CBP is charged with management, control, and protection of our nation's borders. Upgrading and automating CBP systems will inevitably lead to *increased government scrutiny.*

Did you know the CBP enforces over 400 provisions of law for 40 plus agencies? By every measure, the requirements for accurately and transparently conducting your importing activities have become increasingly complicated. And yet, the technological infrastructure and tools used by the people managing your company's importing activities typically lags far behind the rest of your organization. The Modernization Act of 1993 (Mod Act) started us all moving into the era of computer automation and electronic data collection. Have you upgraded and automated your international systems to keep pace with these changes?

Though the Mod Act is over 10 years old, many executives have not realized the dramatic impact it had on shifting responsibility and liability from the government to the importer, a liability that is exponentially higher since the events of 9-11 and Sarbanes Oxley. The federal government after 200 years has moved from government oversight to importer compliance. As a company handling import transactions the feds are now asking if you have taken up the slack and become a good corporate citizen. Or have you, as many others have done, looked the other way, and abdicated your new stewardship responsibilities?

At the end of this White Paper we will provide some thoughts on identifying and quantifying non-compliance on past transactions, measuring the effectiveness of your importing processes, correcting and optimizing critical importing functions within your international organization, and improving communication and relationships with your trading partners.

The objective of this report is to help you:

- ✓ Find answers and resources to objectively measure your importing activities,
- ✓ Explain the importance of effectively managing import compliance through improved communication and control at every level,
- ✓ Provide you with significant insights on how to optimize your company's importing processes in today's ever-changing global marketplace.

We hope this report helps you realize a well managed, viable, and supported International Logistics and Compliance team is as important to your continued success as your Marketing, Merchandising, Operations, Legal and Finance groups.

## **History**

Over 1700 years ago Marco Polo played a very important role in paving the roads for international trade. He may be considered the most famous traveler/trader of all time. At the very young age of 23, he understood the power of information and controls, knowing whom to trust; and the importance of having the “right documentation” to present to authorities. Some wonder if he learned this by working as a tax inspector for three years for the Privy Council under Kublai Khan in 1277. It was from Kublai Khan that the Polo family received the Golden Tablet (Paiza). Also known as the VIP Passport, this tablet gave them protection and entry into many areas of the world and this Paiza was attributed to the safe return of the family and their riches to Venice during the late 1200's. *Things were so simple back then.*

The first United States official Tariff Act (July 4, 1789) authorized the collection of duties on imported goods into the USA. After declaring our independence from England in 1776, our young country was on the brink of bankruptcy and the Tariff Act was implemented to raise money. Four weeks later, the fifth act of Congress established the U.S. Customs department and its ports of entry. For nearly 125 years Customs funded virtually the entire government and paid for the nation's early growth and infrastructure.

Today, the average number of daily commercial import entries is 75,734 with 2004 (FY) fiscal year revenue of \$26 Billion. CBP is now part of the Department of Homeland Security (DHS) and with their 42,000 employees represents about a quarter of DHS's operation. CBP is a merger of all border interdiction functions, authorities and personnel into one border agency to manage, secure and control our borders. With enforcement responsibility of so many complicated laws and with increased national

security concerns, one asks how do our governmental agencies maintain effective oversight and assure the transparency, accuracy and security of U.S. imports. ***Things have become far more complicated.***

Prior to 1993, it was the responsibility of the Custom's office to determine accuracy of documentation, markings and release of cargo. It was the local port authorities that interpreted compliance under the guidance of the National Headquarters directives and rulings. Individual custom's agents reviewed entries on a transactional basis at every port. Customhouse brokers were considered the coordinators and the runners that filed the paperwork in the various ports in compliance with regulatory agencies. The importer was not considered the responsible party and was left to focus their efforts and attention in their core operations.

The Harmonized Tariff Schedule (HTS) world of numbers came into being in the late 1980's. We began harmonizing classifications with other leading trading countries. A few years later, the Mod Act (1993) created major changes that would impact US importers. The Mod Act dramatically changed the responsibility of import compliance by introducing the standard of 'Reasonable Care' and shifting the responsibility of interpreting the many complicated laws and regulations to the importer of record. Reasonable Care dictates that the importer of record must have documented controls in place to assure proper valuation, classification, and compliance with the many laws governed by U.S. Customs. To aid in this transition, the government tried to educate importers to the new rules of engagement. It provided books and manuals with guidelines, warnings, general rules and regulations and other important information. However, most companies did not take the changes and warnings seriously and the considerable impact of the Mod Act did not reach the executive suites.

Executive Management did not realize the responsibility and liability that came with 'informed compliance.' In fact, in the years following the Mod Act, executives continued to defer to 3<sup>rd</sup> party providers and outsourcing thrived as customhouse brokerage services continued to rapidly expand. It took a series of events before the responsibility of compliance and the liability of importing began to seep into the boardroom:

- ✓ Custom's audits began; enforcing their new position with serious fines and penalties,
- ✓ September 11, 2001,
- ✓ Sarbanes Oxley Act of 2002 (SOX)
- ✓ Automated Commercial Environment (ACE)

Despite government efforts over the past 12 years, for many companies their importing processes and technology still lag significantly behind the rest of the organization, but it is beginning to change. Most executives today realize a well managed, viable, and supported International Logistics and Compliance team is as important to their continued success as their Marketing, Merchandising, Operations, Legal and Finance groups. *However, there is a lot of ground to make up.*

### **Inconsistent Advancement in Technology**

The importation world began updating its processes by introducing computer automation long after most other functional operations of American companies. Information technology has advanced to the point that Google now has 800 billion web pages available at a touch of a button. Most companies had fully operational ERP systems, bar coding, EDI, satellite communications and warehouse automation long before the first electronic interface between brokerage firms and importing companies. Many Importers are still waiting for that connection.

*‘The march of technological progress has been uneven. In recent years, change has been more rapid in information processing and health care than in energy, transportation, and other industries. There are many industries that still depend on older technologies that date back to the 19th and early 20th centuries.’*

*Michael J. Mandel, The Innovation Economy – The Promise of Innovation, Business Week (October 11, 2004).*

Importers must shed their older technologies and emerge with systems and controls on par or even surpassing their other operational units. Yet, new technologies develop so quickly, and importing operations are so far behind, that many companies have become overwhelmed in determining which service(s) or provider(s) can optimize their specific processes and ensure compliance, transparency and accuracy of their import transactions.

### **Outdated Processes**

For many organizations, manual importing processes are still prevalent today, hampering the growth and acceptance of automated and integrated systems. In fact, ‘manual’ is a far more accurate description of most import processes today than is ‘automated.’ The methods of product classification continue to be subject to personal interpretations at the port level. In many cases, the considered expert such as the custom’s broker or forwarder doesn’t even see or examine the imported merchandise and relies instead on inadequate, shorthand invoice descriptions. In fact, the International Tax Review has stated that often classification is nothing more than a ‘Random Guess’. *That is simply not good enough.*

## **‘Toxic’ Data**

Inadequate resources, staff shortages, insufficient training and lack of empowerment plague import operations in the typical organization. The complexity of rulings and guidelines requires the classifier to know the origin, use, make-up, relationship and other critical information to make an informed judgment. The mismatch between insufficient resources and complicated requirements lead to inadequate due diligence, reactive judgments, and blatant classification errors. This ‘toxic’ information then feeds the organization’s key technologies and software platforms. Compounding the problem is the lack of integration with many disparate databases and systems spread across multiple divisions, organizations and disciplines. The costs and risks resulting from inaccurate information feeding an importer’s financial systems and the CBP can be staggering.

## **Audits & Penalties**

Penalties can be severe not only for incorrect payment of duties but also for failure to produce records and document ‘reasonable care.’ If negligence is determined, penalties can be \$10,000 or 40% of the value for **EACH** release of goods. Double those amounts if the entry is NAFTA related. The financial impact can quickly add up to hundreds of thousands, or even millions of dollars.

U. S. Customs can conduct a company audit with 30 days notice. And they make money when they do it. Historically for every \$1 spent conducting an audit Customs has collected \$7 through prior disclosures, underpaid duties, liquidated damages and penalties. These figures do not include the importer’s operational cost in assisting in the audit review. Operational costs could further be incurred with reconstruction of records and lost sales due to detained shipments or late delivery if your company is flagged as a higher-risk importer and put on the Enforced Compliance Level.

Further, it is not just the importer of record that is subject to a government audit but the importer’s agents, suppliers, and other third party logistics partners. Circumstances that can trigger an audit include:

- Type of Industry
- Size of Importation Values
- High Risk Goods
- Countries of Origin/Transport
- Prior Disclosures
- Volumes of Supplemental Information Letter(s)
- Inconsistent Classifications
- Links to Third Parties Found Non-Compliant in Unrelated Audits.

## **Increased Government Scrutiny**

Over the next several years, U.S. Customs will spend \$305.5 million to implement the Automated Commercial Environment (ACE), and another \$16.2 million on the related International Trade Data System (ITDS) program. These two modernization initiatives, begun in 2001, focus on cargo import and export operations and operate in conjunction with the Customs Trade Partnership Against Terrorism (C-TPAT). These security initiatives combine with the corporate governance and compliance legislation of the Sarbanes-Oxley Act of 2002 (SOX) to create the most severe scrutiny on America's corporations in our country's history.

It is not only necessary for importers to be compliant with CBP, but also with the many laws and regulations from Other Government Agencies (OGA's). Here are a few of the federal government's new programs and laws that will govern importing activities in the new millennium.

### **ACE**

Over the next several years, CBP will be implementing the Automated Commercial Environment (ACE) and the International Trade Data System (ITDS) programs focusing on cargo import and export operations. The CBP Modernization Program, which began in 2001, will redesign the automated systems that support CBP operations for all goods and people crossing U.S. borders.

The ACE Secure Data Portal will be similar to commonly used internet sites like AOL and Yahoo that offer a broad array of services and features such as search engines and on-line tools. ACE will provide importers with a universal dashboard for data, tools, and information. ACE will also allow CBP to *increase enforcement activity and compliance*. The system will track examination and enforcement results and distribute them immediately to authorized users. It will extend targeting to cover the vast majority of the cargo and conveyances entering the country.

### **SOX**

In the arena of corporate governance and compliance, the Sarbanes-Oxley Act of 2002 (SOX) has commanded considerable attention. Developed in response to accounting scandals that rocked the corporate world, SOX is aimed at improving the transparency and accuracy of financial accounting and record keeping in publicly traded companies.

SOX imposed new responsibilities on corporate executives and boards, to create extensive policies and controls to secure, document, process, and verify material information dealing with financial results. Under Section 404, Management Assessment of Internal Controls, states:

*Technology without process is not internal control. Companies should assess their supply chain, looking at gaps and also redundancies that can compromise control. Inefficient processes should be identified and remedied.*

### **OGA's**

Non-compliance not only creates risk from CBP, but Other Government Agencies (OGA) as well. There are numerous Federal Agencies that monitor imported transactions in addition to CBP. OGA's include FAA, DOD, DOT, FCC, etc. Focusing on one agency will not guarantee free passage through the gauntlet of agencies, rules, regulations and requirements that importers face in the 21<sup>st</sup> century. Increased control and flow of information to OGA's will mean *increased government scrutiny* and *increased complexity of requirements* for importers.

### **The New Model**

Today we are at the intersection of incredibly powerful information technology and global events that have reshaped the international world of trade forever. *This is the new normal.* Importers must effectively balance the twin burdens of increasing government scrutiny over security and financial controls with the intense global competition that pressures their bottom line. Importers must prepare now for these changes and proactively tighten internal controls long before our government agencies begin flexing their more powerful oversight muscles being developed within the ACE program.

A new model has evolved to help importers effectively manage the complexities of system-wide compliance. The new model leverages the *capacity of computing* and the *power of the Internet* in order to help importers optimize the compliance, accuracy and transparency of international transactions and accounting.

Based on extensive data mining expertise, the new model electronically recreates years of past transactions to identify and quantify anomalies, errors and non-compliant activities. It creates executive level reporting to help importers objectively 'see' their import operation as it is. It provides decision makers the information they need to evaluate, prioritize, and implement corrective actions. The new model leverages the very technology that identifies and quantifies system weaknesses to design internal controls that correct the root cause of errors and non-compliant activities. Identifying system weaknesses and proactively correcting them will secure and strengthen your position as a **GOOD CORPORATE CITIZEN** as your company marches toward the ever-changing globalization of the 21<sup>st</sup> century.

The new model is based on four pillars of excellence:

1. Expert information,
2. Fact-based analysis,
3. Superior technology and
4. Unprecedented speed and scale.

The *capacity of computing* and the *power of the Internet* can help importers and their partners create information once, make sure it is correct, and automatically use it everywhere it is needed.

### **Expert Information**

Systems are the most powerful way in the universe to address problems and accurate data is the foundation of an effective system. Accurate classification, documentation of supportive rulings and transparent communication are at the core of a well-managed import operation. Information technology allows the importer of record to manage and control the flow and accuracy of information used throughout the supply chain. Systems can be connected via the internet to allow the importer to effectively share information and *direct* their brokers and other service providers in their functions. Alerts to changing regulations can be proactively identified and integrated so the importer's information is always up to date and current.

### **Fact Based Analysis**

Data mining helps importers learn from the past in order to create a better future. Modern technology is used to electronically recreate years of past transactions, precisely identify errors and non-compliant activities, categorize and quantify past errors, and objectively report the scope of non-compliance so management can allocate appropriate resources to fix the problems. Data mining programs identify errors and anomalies such as incorrect classifications, duty-drawback opportunities and other inconsistencies. Errors are then categorized and quantified so the importer can objectively evaluate the scope of non-compliance and make effective decisions to correct the root cause of errors. Data mining is also used to measure the performance of vendors, brokers, carriers, warehouses and any other third party agents.

### **Superior Technology**

Technology helps streamline the classification process by integrating classification information with enterprise software throughout the import supply chain. Automation of manual processes creates precise classification coding and matching to supportive rulings, dramatically improving operational effectiveness and overall compliance. Data mining processes use sophisticated pattern-matching algorithms to electronically review every transaction and identify many potential areas of non-

compliance. Finally, the logic required to create data mining algorithms is closely linked to the logic required to correct the root cause of the problem so the process of data mining can help importers create requirements for system-wide corrections and improvements. Computer programmers can then leverage data mining logic and results to design internal controls that correct the root cause of non-compliance and eliminate re-occurrence.

### **Unprecedented Speed and Scale**

Decades of data mining expertise and the power of computers have exponentially reduced the transaction costs typically associated with compliance review. Together, they have created efficiencies that can profitably do tasks that traditional methods could not reasonably consider. For example, data mining programs can efficiently review 100,000 or even 1,000,000 line item transactions in a matter of minutes and identify every non-compliant transaction whether there were 10% errors or 1/10%. Data mining programs can detect errors as small as two different ports classifying the same item using two different HTS codes, or as large as an entire category of items being classified incorrectly. Traditionally, importers have not had the time, resources or skills to routinely and comprehensively review every transaction for compliance. The new model can review every transaction with unprecedented speed, scale, and precision.

### **Executive Summary**

As we begin the 21<sup>st</sup> century, importers will be challenged and tested as never before in the 200 year history of U.S. Customs. The stakes related to security have never been higher. The financial scrutiny on America's corporations has never been sharper. And the government's commitment to securing our borders and demanding transparency and accuracy of International accounting and record keeping has never been greater. Non-compliance in the 21<sup>st</sup> century is not a viable option. There is simply too much at stake!

Our government responds to high risk with high complexity. The many laws and agencies charged with assuring safe and secure entry of all goods and people entering the United States has created a confusing and complicated web of complexity for importers. Today, American importers are challenged to balance the additional costs associated with increased complexity of requirements and the need to reduce costs to compete in the harsh realities of the global marketplace. Fortunately, there are two powerful forces to help importers meet these new challenges and thrive as an importer and global company in the 21<sup>st</sup> century.

First, virtually every repetitive function in American businesses can be automated. Import operations are notorious for their reliance on manual processes that keep the staff busy on routine operations, and prevent them from addressing more serious issues related transparency, accuracy and security of U.S. imports. Most companies are only beginning to tap the full capacity of computing.

Second, the power of the internet can be utilized to manage the flow of information and communication like never before. The importing process is a series of transactions between the importer, supplier, freight forwarder, broker, and U.S. Customs. With clearly defined processes, accurate information, and effective communication, the importer can direct and control activity and the flow of information throughout the entire import supply chain: *creating information once, making sure it is right, and automatically using it everywhere it is needed.*

Importers of the 21<sup>st</sup> Century face unprecedented challenges caused by global events that have reshaped the international world of trade forever. This is the new normal. Be prepared for it.

## About Global Data Mining

Global Data Mining, LLC helps import professionals who are frustrated with inadequate resources, and struggling to improve compliance and increase the transparency of import data feeding financial systems and executive leadership.

How confident are you that the import information feeding your financial systems and the CBP is accurate and fully compliant? In many companies, the importing processes and technology lags behind the rest of the organization. An article in the International Tax Review states that classification is often ‘no more than a random guess.’ Inadequate importing processes can create some real liabilities for the importer of record, such as:

- Inaccurate valuation of merchandise,
- Improper classification of merchandise,
- Incorrect payment of duties, and
- Exposure to serious penalties for non-compliance with U.S. Customs.

Global Data Mining helps importers learn from the past to create a better future. Our solution leverages the power of the 3-R’s to electronically *recreate* years of past importing transactions to identify and quantify errors and non-compliant activities, create executive level *reporting* to provide decision makers the information they need to evaluate, prioritize and implement corrective actions, and design internal controls to *repair* the cause of errors and optimize the compliance, accuracy and transparency of international transactions and accounting. We partner with our clients to streamline importing processes, improve operational effectiveness, reduce costs and facilitate overall compliance.

The Chief Financial Officer of a recent client said his import operation was ‘a big black hole,’ that he didn’t have visibility and control of the processes. He commented that our Global Data Mining staff completed an ‘exhaustive review and did a phenomenal job’ identifying nearly \$300,000 in errors. He said, ‘It was shocking to me the amount of errors they identified.’

For more information about how Global Data Mining’s innovative processes and service could be valuable to your company, please contact [info@gdmlc.com](mailto:info@gdmlc.com) or visit our website [www.gdmlc.com](http://www.gdmlc.com) .

## **About the Authors**

**Matt Gersper** is the president of Global Data Mining, LLC (GDM), the world's first international data mining company. He has formed a strategic partnership with Customs Info, the industry's leading U.S. customs research and compliance firm, in order to provide comprehensive services that make their clients more powerful using their combined Information and Technology. GDM's mission is to help their clients make better use of Information and Technology to improve their business systems.

**Jane Kriwinski** is an international specialist with GDM focusing on the rapidly changing regulations of International Trade. Jane has twenty plus years of international front line experiences working as the Import/Export Manager of Safeway Stores and then the International Compliance and Logistics Director for West Marine Products.