

Trade risk management: a global approach

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Abstract

This article discusses IBM's global approach to managing risk associated with importing product into more than 170 countries: why we focus on risk management, our approach to assessing and managing risk, and how we translate risk management into a competitive advantage for our business. Finally, we discuss our plans to develop new insights in the future.

Introduction

The IBM Corporation is a globally integrated enterprise which operates in more than 170 countries. In 2011, with annual revenue of approximately USD107 billion¹ we imported about USD20 billion worldwide. Our business mix is continually changing, moving toward higher value technologies and new market opportunities. Global integration, change, growth market expansion, acquisitions: each of these factors requires that we take a global approach to customs risk management. Global integration of all our major enterprise functions allows us to more quickly implement effective controls throughout our supply chain to mitigate any potential risk to compliance and supply chain security, but it also requires process and system flexibility to adapt to country-unique requirements as we manage country-unique risk.

Regulatory compliance is a given in IBM and the standards to which IBM operates are exacting. The risk we manage is related to achieving our objective of compliance with the laws and regulations governing imports in every country we operate. Each country is important to us, and although progress has been made, not all trade regulations are harmonised. Risk management in this environment is the practice of understanding and identifying those events and circumstances within the realm of our business operations which have the greatest potential of non-compliance. We then ensure that appropriate controls are implemented and resources allocated to prevent the risk of noncompliance and disruption to our supply chain. Within IBM, the Import Compliance Office (ICO) has global oversight responsibility to ensure that IBM's import processes are effectively implemented throughout our enterprise.

When considering stresses in the global economy along with the complexity of our operations, dynamic changes, divestitures and acquisitions, a laser-like focus is required to ensure continued compliance. As customs authorities seek to maintain revenue targets despite a turbulent global economy, risk of customs enforcement increases. Increased physical inspections upon import pose potential delays to our supply chain, and while post-entry audits do not delay our supply chain they do divert resource. In addition, a political desire to protect national economies means that Customs are sometimes enforcing new trade barriers even while countries are implementing new trade arrangements to attract investment and hopefully growth, increasing our need to adapt controls to ensure compliance with new requirements.

We view compliance not only as mandatory but also as strategic. Built on a foundation of strong and sustained regulatory compliance, we are not only protecting IBM's brand image and reputation – IBM's reputation and performance enable us to avoid disruptions to IBM's supply chain and to earn the privilege of using simplified customs procedures which in turn allow us to quickly get goods to market, contributing to growth, improving profitability, and reducing the cost of compliance. In what

continues to be a turbulent economy, importing compliantly and securely demands more from us as we dynamically manage risk.

Understanding risk and properly managing it allows us, as a compliance-focused organisation, to add greater value and provides IBM freedom of action as we grow our business – a real competitive advantage.

Risk assessment and management

In our assessment of risk we look at specific environments, circumstances, events, business operations and imports, assessing which of these, alone or in combination, have the greatest potential to cause noncompliance and disrupt IBM's supply chain. This process forms a basis for deciding how we should manage the risk and for ensuring that controls are in place to mitigate the risk of noncompliance and disruption.

The process of assessing risk also provides the benefit of an opportunity for our global compliance team to assess the potential for issues affecting one country, region, geography, or process to affect another. Although we strive for 100 per cent accuracy, no importer is perfect. Mistakes can happen. The process of analysing risk and ensuring controls are in place to mitigate this, gives us another opportunity to identify gaps at the earliest possible opportunity in our supply chain.

Assessing risk, performing an impact analysis of our exposure, and implementing controls to mitigate our risk are critical components of our 'reasonable care' to ensure the accuracy of the information we declare to Customs.

While risk management occurs continuously, we have implemented a formal structure to periodically identify and analyse risk and processes which allows discussion of controls with the relevant process owners who execute them, and an overview with our extended network of approximately one hundred Import Requirements Executives (IREs) worldwide. These IREs are placed within line organisations such as Sales and Distribution, Manufacturing, Procurement, Finance, Customer Fulfilment, and Global Logistics. They represent the ICO either at a country level or within one of the globally integrated support processes which contribute to compliance. They are usually senior-level management with a broad view of the business and an ability to influence the actions of multiple organisations supporting their mission. Our regular collaboration with the IREs provides a mechanism by which we identify changes to business models, and consider information from their organisation's forecasting or strategic planning activities that could potentially affect our ability to achieve our mission, goals, and objectives related to customs activities. This open channel of communication allows us to proactively manage risk and prevent noncompliance and disruption to our supply chain.

Our assessment captures potential risk from both internal and external sources. In addition to the basic elements we capture which allow us to understand the environment, we identify, consider, and manage risks presented by change – whether new or changing regulations, change posed by rulings and court decisions, or in the economy; in operations; in resource; in the political environment; in major suppliers, contracts, agents, and brokers; by emerging matters of national interest or matters related to protection of domestic industries – all conditions which could affect customs compliance. We also identify risk through consideration of findings from external and internal audits, evaluations, and other assessments – not only in the import process but in complementary and related audits such as overview audits in smaller countries, tax, manufacturing, procurement, logistics audits, and others.

Internal changes affecting operations, resource, operating processes, sourcing, our move to higher value technologies, restructuring, rapid growth and expansion, and imports to new geographical areas all represent challenges to compliance and we must assess our risk and ensure appropriate controls are in place before the change to ensure continued compliance and prevent delays to our supply chain.

Our sources of information regarding risk are layered and include customs websites, the World Customs Organization (WCO), the World Trade Organization (WTO), publications by the World Bank, trade industry associations, advisory committees to which we belong, external consultants, logistics service providers, customs brokers, and other agents operating on our behalf, as well as indices such as the Corruption Perception Index published by Transparency International, and others.

Assessing risk exposure

Through practising risk management our primary objective is to ensure that IBM's internal control is adequate to ensure compliance with the laws and regulations in every country where we import. As we do that we must assess our exposure to risk associated with custom's activities from both a quantitative and qualitative perspective. When considering quantitative risk, we of course evaluate volumes, for example, volume of activity at a country level, perhaps related to a specific trade agreement or simplified procedure, or volume subject to high duty. However, with operations in more than 170 countries and given our continued global expansion, our risk of noncompliance may be greatest where our volumes are relatively low. Therefore, assessing qualitative risk is equally important and perhaps more challenging. While our policy is consistent globally, we must consider unique country customs requirements. Differences also exist in staff with varying levels of experience, training, and knowledge; customs activities, volumes, suppliers, agents, business partners and customers. Manufacturing locations have a specific opportunity to affect compliance in countries receiving goods from them. Because of all the above variables and many more, each location represents a different challenge when we assess customs risk related to IBM's imports and we work very hard to familiarise ourselves with operations at a local level. Often, this knowledge tempers the initial risk analysis. The actual risk exposure may be far less than the initial risk assessment based on controls which have been implemented.

So, although our approach is definitely global, it is also local.

When assessing our risk exposure we consider significance – or importance, and sensitivity – more difficult to assess but critical when protecting your brand image. We can assess significance usually by looking at the value of product to which the risk applies, but in some cases a more subjective judgment is required. For example, an incorrect statement of country of origin in a single instance may be considered of limited significance, but failing to perform a seven-point security inspection when loading a dedicated container at an IBM manufacturing location is of great significance since a failure, in the worst circumstances, could lead to a catastrophe. Determining sensitivity requires judgment based on the circumstances in each case. Some issues likely to be judged as sensitive include issues that have received media coverage, or have been the subject of political interest causing restrictive trade barriers, such as issues leading to antidumping or countervailing duties, controls over the import of used goods, or products containing encryption. Some issues may be both significant and sensitive. Of course, even related to issues of large significance, we also consider the inherent nature of the import to determine how susceptible the circumstances are to noncompliance, for example, automated controls would lower susceptibility.

Once we have identified risk, and analysed the potential impact, we use our assessment to ensure appropriate controls are in place, and resources allocated to mitigate areas of risk. We also use our assessment to develop an annual proactive review plan. Our proactive assurance reviews are one method we use to monitor controls. Designed to provide a reliable and independent assessment of IBM's internal control posture related to import compliance and supply chain security, the primary purpose of our reviews is to determine that internal controls related to cross-border movement of goods and supply chain security are effectively implemented and executed to ensure compliance with customs and other government agency requirements.

The entities for which we assess risk are dynamic and will continue to change as IBM's business changes. There is inherent risk associated with import compliance and supply chain security in any country, for example, impact to IBM's image through negative publicity or potential impact to business results through the loss or suspension of import privileges. This year we assessed more than 60 elements of risk for more than 280 entities (for example, in Hungary IBM Vacs – our manufacturing site – was separately assessed from our Sales and Distribution location in Budapest). Each entity was assessed for its relative risk to the business in six key areas:

- 1. Customs environment.** We assess over 20 elements related to the customs environment to help us determine our risk in terms of transparency, predictability and security. We consider participation in organisations and agreements intended to introduce harmonisation and simplification and facilitate trade, such as the WCO,² WTO³ agreements, Information Technology Agreement (ITA),⁴ Revised Kyoto Convention⁵ and many others. Political and economic changes can have a dramatic effect on the agencies that are involved in regulating goods which are imported so we consider the challenges. Also considered are multiple indices such as the Corruption Perception Index (CPI)⁶ and the Bribe Payer's Index⁷ published by Transparency International, and the Vulnerability to Political Revolt Index⁸ compiled by the Economist Intelligence Unit and published by ViewsWire. We look at clarity of regulations, consistent interpretation, and changes presented by new legislation, and we also look at rulings and court decisions affecting our industry. We consider free trade agreements and participation in customs unions as these may provide some consistency and additional transparency in the application of customs laws. Customs clearance cycle time, measured in some countries, provides an indication of the level of automation and assessing changes may indicate the frequency with which our goods are delayed for inspection. We look at the percentage of national revenue represented by customs duties, the WCO Duty Survey,⁹ and duty rates applicable to our products, and try to determine whether customs revenue targets have changed in that country. These categories help us assess the relative stability of Customs and the transparency and predictability with which they operate.
- 2. The IBM customs environment.** We consider the unique customs risk associated with specific operations at each entity. For example, manufacturing at an IBM facility and whether manufacturing assists are provided to suppliers, manufacturing or assembly in a customs-free trade zone, trading centres, logistics hubs, parts hubs, products shipped on consignment, Global Asset Recovery Services, participation in free trade agreements or special trade programs, trusted partnerships; market – major, or growth.. These help us assess the level of stability within our operations related to customs – the extent to which business changes have an impact on the stability of the location or process. We consider significant changes in tools, systems, operations, and process controls; organisation (anticipated growth/decline), and technology. We also consider changes to external suppliers, contractors, agents, and brokers. We look at acquisitions and divestitures and determine our confidence in risk management through our involvement in the due diligence and integration process. We consider risk across all legal entities authorised to import into any given country.
- 3. Size metrics – values.** We consider the value declared to Customs for both imported and exported goods (since the shipping location must ensure goods arrive compliant with the receiving country's requirements and ready to import). We consider duty paid as some risks associated with proper classification may be greater where duties are paid. Within the European Union (EU), we also consider risk associated with proper declaration of intra-EU shipments to ensure accurate information is declared for statistical (balance of trade) purposes.
- 4. Control program.** The implementation, effectiveness and stability of our control program is assessed from the perspective of the five elements of internal control; control environment, risk assessment, control activities, information and communication, and monitoring. We assess the involvement, stability, and experience of the IRE who represents the ICO locally and also the completion of internal tools which help us assess and manage risk such as the Import Internal Control Program (IICP), import and export profiles, valuation profiles, and supply chain security assessments.

5. **Performance.** We include an analysis of the results of external and internal audits and reviews, and self-assessment and testing results. We also consider any publicly available information regarding customs concerns affecting other companies.
6. A sixth category, **Manager Influenced Criteria**, allows the person making the assessment to apply their intimate knowledge of operations at that location and assess areas we may not have included in one of the other categories. Their assessment carries equal weight as these are the individuals most familiar with IBM's execution in the local environment.

Scoring

Each entity for which IBM is the importer of record is assigned a risk score as a result of our assessment. A score of one to ten is assigned to each element of risk within the five categories (customs environment, IBM environment, values, control program, performance), with one being the lowest risk, and ten being the greatest. The minimum score is six and the highest score is 60.

This scoring provides us with an opportunity to compare and contrast risk across geographies and we compile a list of those entities which received the top ten scores which is used in the communication discussed below. Our assessment also helps determine the suggested frequency of our proactive assurance reviews. Locations or processes considered very high risk might have a review every year, while the lowest-risk locations could be selected for review less frequently. In some countries, review schedules are determined by agreements with Customs based on trusted partnership self-assessment requirements and are executed on a defined schedule to ensure continued eligibility for participation in specific programs.

Communicating risk

We summarise our identification of risks to customs compliance, and analysis for possible effects – our final assessment – into an executive summary which we communicate to those who need the information. This includes our executives, our practitioners, our internal audit organisation, and the business controls groups supporting the globally integrated enterprise. We include in our summary identification of key comparisons and contrasts, our 'top ten' scoring risk entities with a clear, concise articulation of the risk and potential effects, mitigation actions, a 'watch list', and our outlook for the remainder of the year. This information helps us ensure that our objectives relating to compliance are clear and consistent, enterprise-wide, and that the clarity of our assessment ensures we have relevant, reliable information for decision-making; that our resources are allocated appropriately, and that we maintain an environment and organisational structure which supports compliance.

Conclusions and future challenges

The sustained turbulence of the global economy dictates continued changes in the customs environment. Maintaining regulatory compliance in this environment requires dynamic assessment and management of risk and, as stated earlier, a laser-like focus. As a globally integrated enterprise doing business in more than 170 countries, our approach must be both global and local. Trust and personal responsibility in all relationships are core values expected from every IBMer. IBM's value system integrates a strict set of ethics and standards which guide us as we strive to establish and maintain trust with customs and other agencies governing our imports. With regulatory compliance a given, IBM continues to improve and refine our understanding of risk so that we can maintain our reputation as a compliant importer, a trusted partner, and deliver a real competitive advantage to the business through freedom of action. We are not only protecting IBM's brand image and reputation – IBM's reputation and performance enable us to provide business certainty through avoiding disruptions to IBM's supply chain. Our trusted partnerships

with Customs afford us the privilege of taking advantage of simplified customs procedures which in turn allow us to quickly get our goods to market, contributing to growth, improving profitability, and reducing the cost of compliance.

What does the future hold?

We are working to find a smarter way to perform risk analysis through making it more instrumented, interconnected, and intelligent. IBM Business Analytics has capabilities related to governance and risk and compliance. If we can compare risk indicators to actual shipment data we believe we can predict which shipments, events, and circumstances have the greatest potential for non-compliance. We believe we could develop new insights based on statistical methods and analysis applied to our data, leading to better and more informed decisions. We would be better able to spot trends, patterns and anomalies, compare ‘what if’ scenarios, predict potential threats and opportunities, better identify and manage key risk and plan resource. With these deeper analytic capabilities we could better understand, anticipate and shape business outcomes, perhaps managing global risk in a smarter way.

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Notes

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- 2 World Customs Organization, viewed 25 July 2012, www.wcoomd.org/home.htm.
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