



customs update: why sarbanes-oxley is important

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Financial and legal publications are full of articles about Sarbanes-Oxley, the law which took effect in 2002 in response to the financial shenanigans alleged to have occurred in companies like Enron, WorldCom, Tyco, to name a few. In its simplest terms, Sarbanes-Oxley (or SOX as it has become known) requires the CEO and CFO to certify to the Securities and Exchange Commission that the internal controls the company has in place are adequate to insure: 1) the proper authorization of the company's transactions; 2) the company's assets are safeguarded against unauthorized or improper use; and 3) the company's transactions are properly recorded and reported to permit preparation of financial statements in conformity with generally accepted accounting principles.

In other words, a company is expected to have sufficient internal controls in place so that its management is able to reasonably assure the reliability of its financial reports and financial statements by external users, especially shareholders. Additionally, these internal controls must assure the prevention or timely detection of unauthorized financial activities which could have a material effect on the company's financial statements.

The long and short of it is SOX is intended to protect a company's assets and to give shareholders an accurate and complete picture of how the company is making and spending its money. If so, why should SOX encompass international trading activities? Well, first let's make clear that SOX only applies to publicly traded companies. However, for those of you working in companies not traded on a stock exchange, you need to consider the consequences of SOX for one simple reason -- it affects you, too!

When Customs audits an importer, one of the criteria insisted upon is that a company have documented internal controls. The auditors do not distinguish between those company which are privately held and those which are publicly traded. All are required to adhere to the same standard. The same is true when dealing with other regulators, including the U.S. Attorney's Office in the event of

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criminal cases. In fact, if a company is involved in a criminal case and the crime arose from circumstances which were not handled in accord with the company's internal controls, under sentencing guidelines, a downward sentence adjustment is called for. We are all familiar with the lenience which results with Commerce, State, Treasury, Customs, for example, when filing a disclosure about past violations.

When dealing with trading issues, implementation of SOX raises all sorts of potential problem areas. Let's start on the export side. Does the company screen for licensing requirements and prohibited end users and uses? This is a requirement of State, Commerce and Treasury, but SOX also demands it. If a company does not screen, it exposes itself to serious penalty action and/or criminal prosecution, both of which impact the company's bottom line. If the company's revenues are reduced, the dividends it pays its shareholders and the value of its stock are reduced, thereby making the company less valuable and profitable. Is there a more financially negative impact?

Similarly, on the import side, there are activities which demand attention. For example, does the company employ multiple brokers? If so, how are their activities managed? What does a company do to determine the correct classification and value of its goods? What does a company do to make sure the same goods are entered identically at each port of entry? Here, too, the failure to properly manage the operation be disastrous.

The requirements of SOX are not intended to reach every mistake, only those which materially impact the company's bottom line. In other words, a \$1,000 mistake gets viewed differently than a \$100,000 or \$1 million mistake. Nonetheless, they all have to be detected and dealt with. It is the level of scrutiny a company applies to each which is the focus of SOX. The \$1,000 error might result from a simple mistake and so be properly addressed within the department where it was made. However, the bigger the headache, the greater the level of scrutiny and the higher the rank of the reviewers.

Whether publicly traded or not, the internal controls demanded by SOX are a good idea for all companies, regardless of size, for purely sound business reasons. The bottom line is not helped by unexpected duty increases, seizures, penalties, shipment delays/costs or, worst of all, bad publicity - all of which inevitably undermines brand name value. There is nothing worse than trying to explain to a buyer that you are unable to deliver the order because your own government won't let you ship!