KPMG

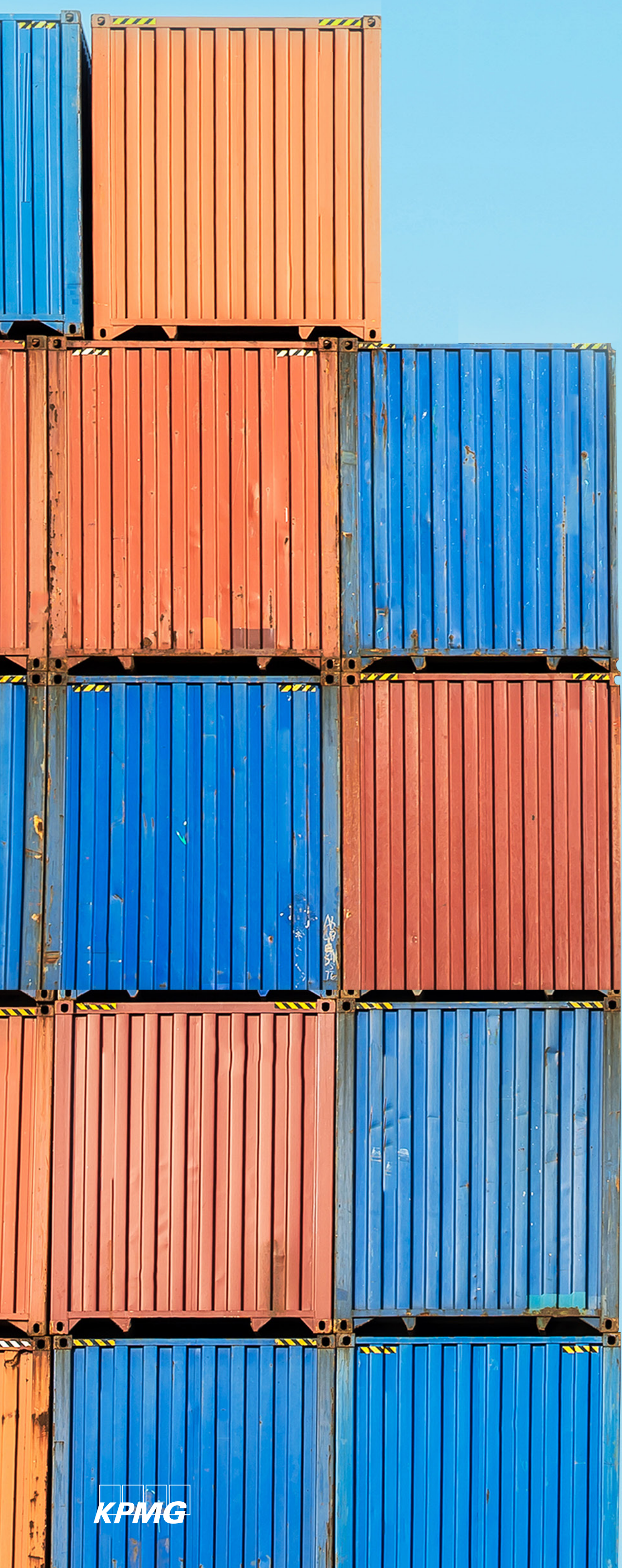
Key controls for export compliance programs

Why they matter

August 2020

kpmg.com

Introduction



Export controls are becoming increasingly complex with new items added to control lists, enhanced restrictions around end-users and more businesses directly interacting with consumers. This is coupled with significant enforcement of export control violations.

Consequently, we have seen an explosion in companies who want to establish a robust export compliance program based on a comprehensive risk assessment. Through teaming with these companies we have evaluated a wide variety of programs ranging from highly evolved with significant automation to more simplistic. Regardless of the sophistication level, many of these programs have successfully achieved their goals of identifying export control risks, and establishing processes to address and manage risk.

However, we continue to see a re-occurring theme within these programs: failing to identify "key controls" or, when they are identified, insufficiently validating, probing or enhancing them. Since key controls are the dynamic linchpins driving compliance programs, when they fail it results in a snowball effect compromising the entire program and, ultimately, resulting in operational or regulatory errors. Identifying, validating and modifying key controls as your company evolves ensures program relevancy. In this article, we will explore what a key control is, how to identify them, and how to monitor them through the use of a key control matrix.

Key controls—what they are and why they matter

Many export compliance professionals are not familiar with the concept of "key controls," largely because they have not been widely discussed within the industry or by government regulators. As a result, key controls are generally not given enough consideration within an export compliance program ("ECP"), leaving companies exposed. Instead, the focus largely tends to be on developing and implementing processes or procedures tailored to their unique business profile, which is an appropriate starting point. However, establishing and continually evaluating key controls within those processes often forms the underpinnings that make that process effective.

To better understand how key controls function within an overall compliance program, we can look to definitions used by internal auditors. The Institute of Internal Auditors proposes the following:

A key control is a control that, if it fails, means there is at least a reasonable likelihood that a material error…would not be prevented or detected on a timely basis. In other words, a key control is one that is required to provide reasonable assurance that material errors will be prevented or timely detected.[1]

This definition could easily be applied to managing export control risks. Embedding export control considerations into business practices is part of mitigating risk. But that's just a piece of the overall compliance picture. For each ECP process or procedure, there is at least one action or step that must be completed correctly for the procedure to remain effective. If this step fails then it becomes more likely than not that a "material error" will occur. For export compliance purposes, a "material error" is an error that is likely to result in a potential violation. The key control is the backbone of the process.

The Institute of Internal Auditors' guidance further states that "[c]ontrols may either prevent errors or detect their occurrence. . . [m]anagement should recognize that an efficient and effective system of controls will use a combination of both[.]"[2] Export compliance managers ("ECM") should keep this in mind as they are structuring their programs and managing their key controls. While preventing an error is the ultimate goal, it is also critical to detect potential violations. Failing to identify and subsequently monitor the key controls in the internal audit program could mean errors are undetected and undisclosed. Identifying and self-reporting potential violations to the enforcing agency is a significant mitigating factor in determining fines and penalties. If a violation detection control fails, the entity may lose an opportunity to get ahead of a potentially complicated situation.

As ECMs think about the key controls driving their programs, it's important to remember that "…there is no generic 'laundry list' of what will always be considered a key control and, due to differences in systems, procedures, business environments and models, sound professional judgment is required during the identification process."[3] One of the most pervasive challenges among export controls programs is overlaying a cookie cutter compliance approach to the business, with the assumption that all controls are equal. Invariably, the company is surprised when a compliance error occurs because management believed it had a strong program in place. However, while that program may have been objectively robust, it was not appropriate to the business. Similarly, key control identification is a highly individualized process requiring the ECM to look at what makes each process effective based on the entity's unique business needs and challenges, and testing, monitoring and adjusting that process. Relying on generic key controls will not achieve the ultimate goal of preventing systemic errors.

---

[1] "Sarbanes-Oxley Section 404: A Guide for Management by Internal Controls Practitioners," *The Institute of Internal Auditors (Jan. 2008), pg. 31*.

[2] *Id.* at 32.

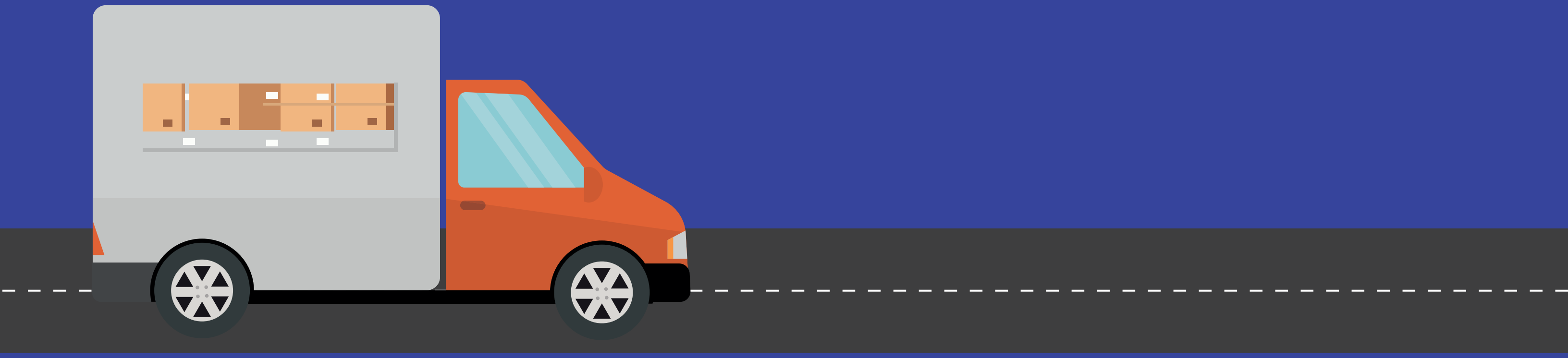
[3] *Id.* at 32.

How to establish key controls

Key controls are the end product of a robust risk assessment. A risk assessment is the starting point to establishing or enhancing a compliance program and is typically a holistic assessment of the company's business profile, product line, internal dynamics and vendor and third-party relationships. At the conclusion of it the ECM should understand the risk hierarchy within the organization. The next step is designing processes to mitigate that risk and to identify potential violations. Too often this is where export compliance managers stop—processes and procedures are designed, implemented and even tested without an understanding of what makes the process effective, or how a process could potentially fail. The critical third step is to identify the key control by dissecting each process.

While this is a highly fact-specific analysis and some processes have multiple key controls, some examples include:

Risk	**Export classification**	**License management**	**Deemed export**
Control	Engineers complete a form to assess whether exported products containing encryption are controlled	Exported quantities of licensable goods are managed in a Global Trade Management ("GTM") system.	All new personnel must be on-boarded through Human Resources
Key control	The questions included on the form that result in an ECCN determination	GTM is correctly configured to account for appropriate license value, quantity and expiration.	Human resources is the gatekeeper for identifying new personnel, including full-time, part-time, internal transfers, temporary workers, interns and others, whose in turn must be evaluated for deemed export considerations
Why this is the key control	If this form is inaccurate or incomplete, or does not ask potentially relevant questions, the ECCN determination could be systematically incorrect	If the system does not reflect the correct products then the licenses will not be properly decremented.	HR has full visibility across the enterprise to new personnel. If HR is not the only entry point, then deemed export screening will not be effective.



It is equally important to understand what part of your processes and procedures are *not* key controls—but rather procedural controls. For example, most companies have a process wherein a product line's classification is determined prior to being released. While this an essential component of managing export risks, it is not a key control. Comparatively, the information used to make a classification determination is a key control area. If the information collected is incomplete (e.g. a form that doesn't ask all relevant technical questions), it could result in a substantial number of incorrect classifications. Essentially, this would be a catastrophic failure of the process control.

Again and again we've seen instances where an ECP had solid controls in place; however, because the key controls were never identified, there was ultimately a violation. A 2019 BIS penalty case offers an example. In that case, a company used an apparently expired export license to export cattle prods.[4] The key control in that instance is the mechanism to monitor license expiration. For example, setting a calendar reminder for the license application would not be an effective key control because the employee may leave the company, others may not have access to the reminder, and it would be difficult to monitor. On the other hand, using a Global Trade Management solution that tracks license expiration dates could be a key control, as long as sufficient measures were implemented to ensure the information was actively entered, reminder notices were correctly set, and exports were not allowed to occur against an expired license. This is not an unusual situation—many companies recognize the initial compliance actions that must be taken but struggle with on-going compliance. Key control identification alleviates some of that pressure.

Key control identification is the backbone of any ECP. But identification alone isn't sufficient to validate that your ECP is in good working order. Documenting the key controls in a key control matrix is the next step to strengthening an ECP.

[4] *In the Matter of: Cotran Corporation,* U.S. Dept. of Commerce, Bureau of Industry and Security (Nov. 7, 2019).

Developing a key control matrix and testing key controls

A key control matrix is crucial in documenting the ECP's core compliance drivers and developing risk-based testing plans. First, by memorializing the ECP's key controls it provides a starting point for all discussions about enhancing compliance and managing risk—subjectivity is eliminated.

Second, it enables internal resources to focus on the core issues. This is crucial because although export compliance covers a wide swath of issues, most trade teams are lean. A key control matrix is a compass that tells them which path to follow to manage risk for their organization, and where to deploy resources. Otherwise, we often see a disorganized approach in which small teams are monitoring every perceived compliance risk, without discriminating between material and immaterial risks, or examining the key controls that may lead to risk. By contrast when a key control matrix is in place, the trade team understands how the biggest risks are managed and monitored.

The information contained in a key control matrix varies based on the enterprises' particular risk profile but is most useful when it includes the following elements:

- Risk name and description;
- Risk level;
- Process or procedure control;
- The key control, description of the key control and who performs or "owns" it; and
- How the key control will be tested, testing frequency, who performs the testing and how results will be documented.

Once this matrix is in place, a testing plan that validates these controls should be developed. This testing plan should be executed at regular intervals based on potential risk exposure. Further, the results of each testing cycle should be validated against earlier cycles so that trends can be identified early.

Key controls often need to be modified as the business grows and changes. As the enterprise evolves, the key controls may decline in effectiveness as they lose relevance to daily operations. The results of the testing are important not just to identify a gross failure but also a gradual decline. Once it is determined that the controls must be modified action should be taken within a pre-determined timeframe. Further, an escalation strategy should be developed that can be quickly executed when the key control fails. This will enable the trade compliance team to mitigate risks to prevent continuing violations.

Key controls are pivotal to ensuring the integrity of the program as well as being an indicator of when changes are necessary. It is a way to check the program's foundation for cracks.

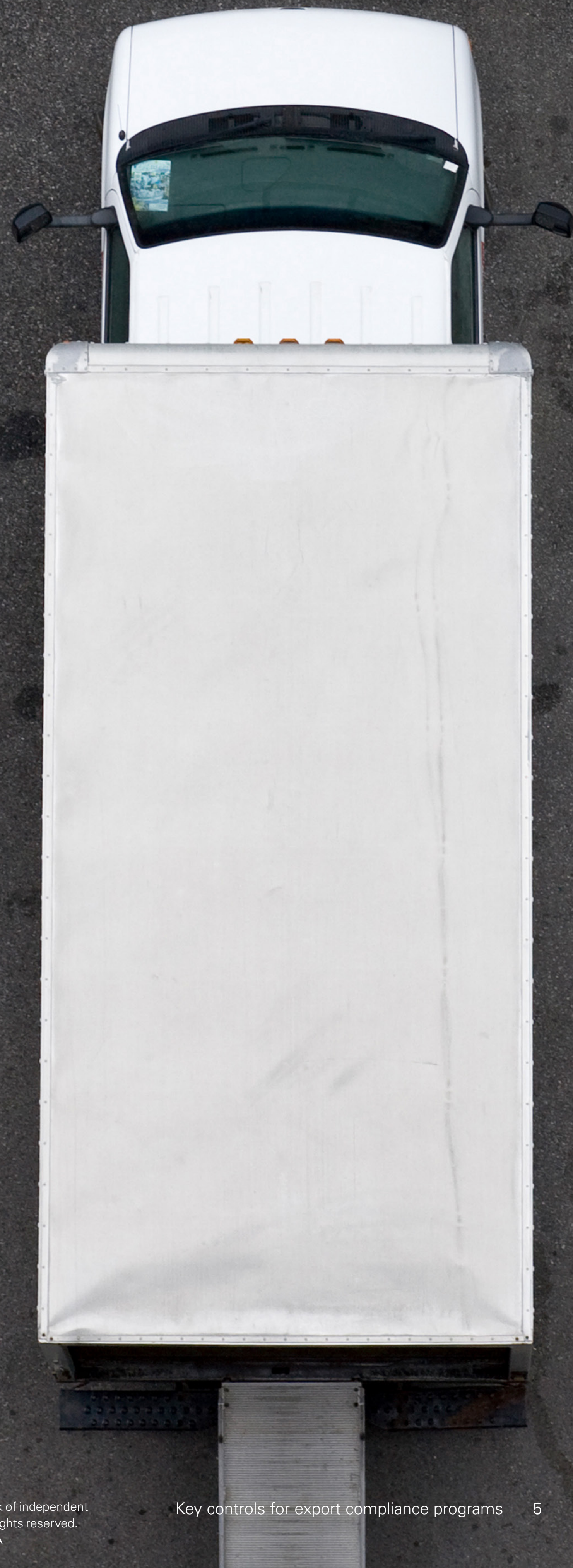
How we can help

Managing risk requires understanding what is driving it. The typical precursor to a key control matrix is a risk assessment.

This gives the export compliance manager visibility into the specific risk issues unique to the organization. With this in place, the export compliance team can develop and implement processes and procedures to manage those challenges. Simultaneously, the team can identify the key controls within these processes and document them in the key controls matrix. Training can then be provided to the relevant stakeholders on both the process controls and the key controls, so they are sensitized to the difference and their importance in maintaining compliance.

It can be overwhelming to deconstruct procedural controls while also managing transactional compliance. For companies that don't have a strong grasp of their risk profile, it can be especially challenging. We can help you pinpoint your risk areas, enhance controls, document key controls and develop a testing plan. We understand the importance of aligning business needs with compliance to create streamlined processes supported by robust key control matrices. We also know that the export environment is becoming more complex by the day, and we can help your program adjust to the evolving requirements.

Making the time investment today in your export compliance program is likely to prevent a violation tomorrow.



Contact us

Steven Brotherton
U.S. & Global Export Controls & Sanctions Leader
T: +1 415-963-7861
E: sbrotherton@kpmg.com

Elizabeth Shingler
Manager, Tax, Trade & Customs
T: 267-256-2691
E: eshingler@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia