



# **Consider These 5 Things**

**Why Conduct Your Own  
Internal Audit? Part I**

**IESS, LTD**  
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## Why Conduct Your Own Internal Audit? (Part I)

Relying on external auditors is a great way to prove that you are fulfilling some of your obligations to meet reasonable care standards. There are also other advantages to doing your own internal audit. It reveals biases and bad behaviors in your processes. It helps your employees train their eyes to notice compliance problems. The management and C-Suite start to get a clear picture of their liabilities and exactly where they need to mitigate. It puts your suppliers and vendors on notice. It saves your company the costs of exploration audits.

## Companies That Don't Do It, Don't Know

In our work, we have found that some companies honestly do not know what to do. There is no question that their disheveled trade program has been borne out of rapid growth, sudden success, or a rash of mergers and acquisitions that have made it nearly impossible to wrap their hands around their trade program. This can also be true in micro-companies with three employees. We've also seen it in M&A deals of billions of dollars. Those companies know that they must pull themselves out of that state and they often do. Then, there are companies that do not fit in this category. Some of them engage in practices that are going to have an impact on their culpability when they finally must confront it. That message is usually delivered in the form of penalties. Part I of this topic (this whitepaper) reveals the hidden symptoms behind a failing audit and trade structure . . . biases. When you perform your own internal audit, your entire company becomes aware of the biases, can correct them, and provide the training ground for your employees. This month's white paper will be two-part. **The first part will focus on some of these biases and why you can't ignore this vital part of an internal audit. Part II will be released around April 15<sup>th</sup> and will offer suggestions on how to design and launch an internal audit.**

You don't want to jump right into an audit, especially if it is the first time your company has conducted one. Jumping straight into the audit phase without doing any soul-searching can frame the audit in a bad light and can virtually eliminate the chances of you ever being able to conduct a second one. I suggest you tread softly at this stage and look at what type of biases exist in your company. Two of the most common are self-blinding and selective interpretation biases.

**What is self-blinding?** When executives engage in this type of behavior, they create barriers or allow silos to form (Departmental Siloing) in their companies that have the effect of masking or concealing free-flowing information in the organization that would enable employees to catch a trade violation. Here is how self-blinding is addressed in Title 15.

“Do not cut off the flow of information that comes to your firm in the normal course of business. For example, do not instruct the sales force to tell potential customers to refrain from discussing the actual end-use, end-user, and ultimate country of destination for the product they are purchasing. Do not put on blinders that prevent the learning of relevant information. An affirmative policy of steps to avoid “bad” information would not insulate a company from liability, and it would usually be considered an aggravating factor in an enforcement proceeding.” ([Supplement No. 3 to Part 732, Title 15](#))

“Knowledge possessed by an employee of a company can be imputed to a firm so as to make it liable for a violation. This makes it important for firms to establish clear policies and effective compliance procedures to ensure that such knowledge about transactions can be evaluated by responsible senior officials. Failure to do so could be regarded as a form of self-blinding.” ([Supplement No. 3 to Part 732, Title 15](#))

**What is selective interpretation?** Sometimes companies will develop a culture of partially applying the trade regulations (import, export, OFAC, or licensing) or strategically working through the regulation requirements in a way that allows them to misapply trade agreements, avoid compliance issues, and exploit ambiguities in the regulations. The reasons executives engage in this behavior is to meet some pre-determined economic, political, financial, or strategic objective. This is usually quickly followed by a cost-risk analysis that provides the justification of a penalty or fine as merely a cost of doing business (ie., “We will make so much profit that if we are caught, the fine won’t matter”). At first glance, it may look like the intention is to comply, but what is lacking is the commitment, the framework, and the engagement.

Why did I bring up these biases? I bring them up because these are the types of organizational biases that also show up when you are conducting an audit, even if you do a super-secret internal one. The regulators know that companies develop these biases, among other things. If you have these biases in the culture or organizational structure of your company, it can have an impact on your culpability level and ultimately your penalties. That is why internal audits are important. This is also why we recommend that you start here, rather than just diving into an audit.

### **Consideration #1: Your employees could be your best defense against penalties**

Your employees are the most powerful weapon you have in your arsenal because, as a body, they hear everything, see everything, and can spot anything. There is no way that you, as the sole person carrying out the mission, can (or should) be the focal point, but in the beginning, it may feel that way.

### **Consideration #2: If People Get Agitated When You Bring Up Import and Export Compliance, That Agitation is a Symptom. Lean In.**

You may already be able to identify the corporate biases based upon reactions to initial conversations. Take note of how I wrote that last sentence. I wrote *corporate biases* because it takes root in the whole company. Rarely is it owned by just one person. Don’t react. Make a mental note. Listen to their opposition because that will give you clues on how to move forward. See how many biases you can identify in your company because that is your roadmap to where the violations may have taken place. The people in your company did not wake up one day and decide to develop biases. They developed over years, decades, and were reinforced by the successful completion of project after project.

### **Consideration #3: A Commitment Letter is a Line in the Sand**

For a company that is riddled with biases, just getting the policy statements done can present a struggle. Start here. I have watched this take months or years to get the policy statements and commitment letters finally distributed. Do not get discouraged. If your company already has policy statements and commitment letters, you may just need to review them and maybe update them to include export and import compliance. If they do not have an existing policy statement and commitment letter, lacking that foundational document can be seen as a red flag to regulators.

### **Consideration #4: The Transaction Files Can Give You a Clue**

CBP refers to the “(a)(1)(A) list” as a general guide to what type documents are required to be maintained as part of the recordkeeping process. You can look at some random shipping files to see if they contain everything they should contain. Some industries require more documentation in the record retention than others. Review the list entirely and identify what you are required to keep. The (a)(1)(A) list pertains to imports. Section 762.2 pertains to exports. If you look at five or six transaction files and they are not complete, that is another hint of what your internal audit might reveal. (See [Appendix to Part 163, Title 19](#) for the (a)(1)(A) list; See [§762.2 Records to Be Retained](#))

### **Consideration #5: You Can “Package” An Internal Audit as a Good Thing**

When biases exist within the company, it is common that no one wants to deal with the consequences of an audit, even if it is an internal one. Employees tend to see audits more like investigations and may feel like they are at risk. If your company has an internal audit department, your company is accustomed to this activity. If not, consider selling this in another way, so that it will be more readily accepted. For example, repeatedly telling employees that **their names are not associated anywhere in the audit records** can bring relief. You can also **explain how intense an external audit may be** and that by conducting an internal audit first, the company will address as many problems as it can before the external auditors

arrive. You might even **consider not using the word “audit.”** Maybe using the word examination, survey, checkup, or study might lower the intensity level. Another tactic is to **advise employees that the exam/survey/checkup/whatever, is to set a baseline for the company** and that it is not to shine a light on any single employee who unknowingly missed something.

## What Are the Steps You Could Take Now?

### Ask yourself the following questions.

- 1) **Does your organization already have a management commitment letter and a compliance policy? If so, does it include compliance with import and export trade regulations?** If the answer is “no,” you can do an internet search for a management commitment letter that you can customize for your own purposes. Many high-value companies publish their management commitment letters, so you might even be able to find one in your industry. This is a public acknowledgment of the company’s responsibilities and sends a message that they intend to comply.
- 2) **Is it difficult to start up the conversation?** If the answer is a resounding “yes,” then there are issues. However, the only issue might be a lack of understanding or knowledge which can be easily remedied, but it might mean something more.
- 3) **When you listen closely to what leadership says about compliance, do their comments reflect biases?** These are *actual statements* that have been said *directly to me* by *sophisticated importers and exporters*.



- 4) **What makes compliance at your company difficult?** Fear of the unknown? Fear of the already known? Lack of desire to intrude upon the sales process? Cost and profit considerations? Supplier sensitivities? Lack of willingness to change?

Inability to motivate employees? Antiquated industry-based norms and routines? A belief that the competitors are doing what you are doing? Find as many of these reasons as you can. It will help as you move forward.

## **Deploy some best practices for setting up a starting point for a compliance initiative:**

### **Best Practice #1: Establish your own focus.**

You may not be able to get everyone on board until you can fully defend your position. We have seen this more than once. Depending upon your product and industry, there may be some risk factors that outweigh others. Apply what you know about the industry, market, and product, then get familiar with the landscape. You can always jump on our calendar for a brainstorming session. I can't tell you how many times we have done that! Personally, that is one of my favorite things to do and it keeps me strategically agile!!!! One of the advantages of having IESS involved is you can have an exploratory conversation before bringing it up to your brokers, your internal auditors, or others who may have a duty to report. There is a wealth of information out there and we are happy to point you in those directions.

### **Best Practice #2: Train up!**

CBP cares a lot about classification, valuation, appraisal, country of origin, markings, and how trade agreements are applied. One of the things that you can do is require employees in key areas to take advantage of free training opportunities. You can make it part of their evaluation process or even internally reward it. There are tons of free training opportunities from CBP, BIS, law firms, regulators, and the National Customs Broker Freight Forwarders Association. This will help the company to start dealing with the biases that block compliance and auditing successes. On our website, we have a list of sources of [free training](#). As employees learn more, they may start to initiate dialogs with you and accelerate your compliance initiative because they learn what is right and often will become your drivers!

### **Best Practice #3: Identify Your Team**

You will not be able to go-it alone for long. Compliance is a companywide initiative. Responsibility should be spread throughout the organization. Having a group of employees behind an initiative is just as important as having a group of executives behind it. If you want to do your own internal audit, you will need support of both sides.

### **Best Practice #4: Read Part II of “Why Conduct Your Own Audit” Coming Out Mid-April.**

If you find that you have some disconnects in the information-flow around the company or discover that questions are not easily answered, don't panic. In our opinion, the next step is not to invest tons of money on an external audit. We prefer that clients look at their situation first on their own and solve the problems that they can internally. We can help brainstorm the solutions with you. Then, when it is time to bring in an outside expert, you will know that you have already saved money by addressing some things on your own. The mid-April release will also include some tools and suggestions you can use to design your own internal audit. You can also reach out to IESS and we will be happy to have that dialog. It exercises our brains to talk about something we already know from different perspectives!

### **Best Practice #5: Detect the biases and silos now.**

A chart below lists common biases and examples of the activities. We have also included how those biases could be viewed by enforcement agencies. Try to detect any biases your company might be experiencing now that prevent compliance and figure out what problems those pesky departmental silos were built to address. Taking down a silo too quickly and without research, might cause an old, long-since-solved problem to reappear. Maybe a new, permanent resolution needs to be put in place to address what the silo fixed.

For more information, contact us via email [workrequests@iessltd.com](mailto:workrequests@iessltd.com) or schedule an appointment with one of our customs brokers by [clicking here](#).

Supplement: Types of Exposures Based on Bias

NOTE: Culpability levels are assigned by the investigating authority after an investigation and are not assigned based upon the type of bias

Bias	Example of an Associated Compliance Failure	Possible Culpability Level	Additional Exposures
Status Quo Bias	Using outdated licensing for new tech products; using old HTS numbers that no longer reflect the product.	Gross Negligence	Debarment (loss of export privileges); import penalties (esp. if there is duty lost)
Cost-Over-Compliance	Sourcing from unvetted, below-market entities and regions	Knowing/Willful Violation	Supply chain seizure due to supplier use of forced labor, child labor or indentured labor.
Data Fragmentation	Missing a “denied person” due to data being in two different systems	Negligence	Internal investigation costs and legal fees
Departmental Siloing	Sales ignores a red flag from compliance	Negligence	Potential for “know or should have known” violation
Selection or Sampling	Auditing only high-value fraud, but missing low-value fraud	Negligence	Increased scrutiny on future shipments
Incentive Misalignment	Shipping “at all costs” to hit year-end targets	Gross Negligence	Up to 20 years imprisonment for executives
Technological Lag	Screening against 2-year-old watchlists	Negligence	License revocation; denied trade access
Groupthink	Failure to challenge a senior executive’s “grey area” deal	Gross Negligence	Criminal fraud and false statement charges
Legacy Systems Bias	Spreadsheet errors leading to misclassification	Negligence	Business interruption; operational stalls
Short-Termism	Ignoring sanctions to capture immediate revenue	Gross Negligence	Prison sentences for responsible individuals
Normalization of Deviance	Workarounds becoming standard practices	Knowing/Willful Violation	Systemic fraud investigations
Under-resourcing Bias	Lack of staff or staff training leads to missed flags	Gross Negligence	Loss of trust from partners and customers