



# The Implications of Fraud Prevention on Transaction Consideration

**Presented by**

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# What We Will Cover Today

1. The Fraud Landscape
2. Fraud Prevention and Detection and the Application of Forensic Tools
3. Transactions and the Foreign Corrupt Practices Act (FCPA)

# Today's Speakers

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**Randall Wilson CPA, ABV, CFF, CFE, Cr.FA, DABFA**  
**RGL Forensics**

Randy Wilson is a partner at RGL Forensics, a global forensic accounting and consulting firm, and leads the firm's global fraud practice. A globally recognized financial forensic expert and certified fraud examiner, Randy has been featured in international publications and major media outlets including NBC News and *Financier Worldwide*. Randy quantifies losses, traces assets and identifies financial motive for fraud schemes ranging from arson and embezzlement to misappropriation and theft. He helps companies detect and prevent theft or fraud, and works with insurance companies on fraud and fidelity claims.

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**Mark Jenkins MBA, CFE**  
**Fidelity Forensics Group**

Mark Jenkins has over 18 years of experience in conducting investigations and providing financial analysis including 11 years with Deloitte Financial Advisory Services LLP. He has in-depth knowledge and skills in managing investigations in both domestic and international environments. He has provided investigative and financial analysis involving white collar crime, litigation support, and business interruption/fidelity insurance claims to numerous business entities.

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# Today's Speakers



**Christopher Meadors CPA, JD, CFF**  
**Fidelity Forensics Group**

Chris Meadors is a licensed attorney and a CPA with over 10 years of experience in accounting and law. Prior to joining Fidelity Forensics Group, he was a Senior Manager with Deloitte working in the Forensic & Dispute Services practice. Chris's experience includes litigation consulting (including expert services), corporate investigations, arbitration, anti-fraud consulting, and Foreign Corrupt Practices Act compliance matters. He advises clients in a wide range of financial and accounting related investigations and litigation. He is also experienced in leading teams of accounting, finance and technology professionals assisting clients in analyzing and evaluating corporate and financial data.

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**Matthew Morris CFA, CLP**  
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Matt Morris is Managing Director of RGL Advisors in Dallas. He is a veteran investment banker with 15 years of experience advising corporate clients and shareholders in transactions and has advised on more than two-dozen transactions with an aggregate value in excess of \$2 billion. Concurrent with his role at RGL Advisors, Matt is a Partner at the international forensic accounting and corporate finance firm of RGL Forensics. He also focuses on the valuation of equity and debt securities and intangible assets for transactions, financial reporting, tax reporting and disputes, and commercial litigation.

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# 1

## The Fraud Landscape

# Fraud and Occupational Fraud Defined

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## *Fraud*

“A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment”

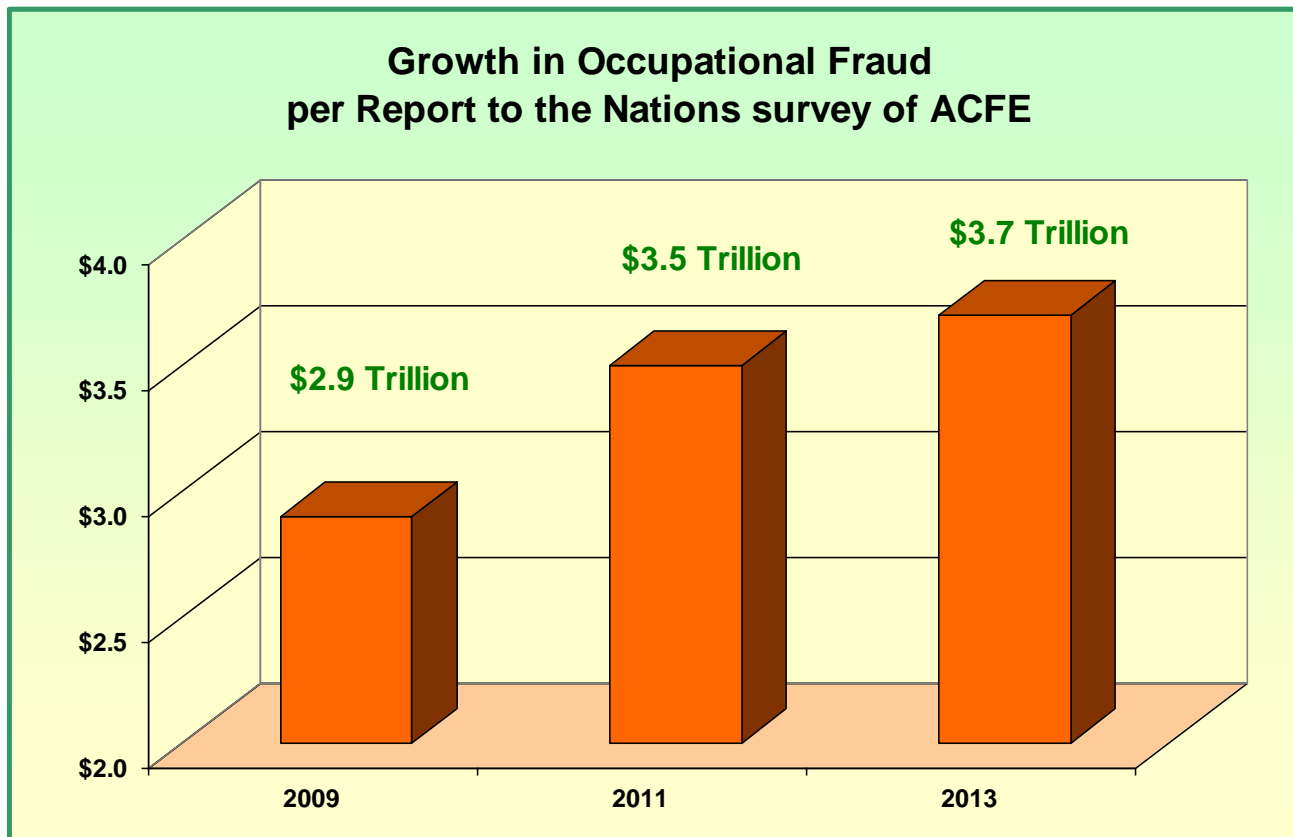
Black's Law Dictionary

## *Occupational Fraud*

“The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets.”

2014 Global Fraud Study  
Report to the Nations on Occupational Fraud and Abuse  
Association of Certified Fraud Examiners (ACFE)

# Cost of Fraud



According to the ACFE's Biennial Global Fraud Studies, the cost of fraud continues to rise.

This is astonishing given the awareness of fraud in the wake of the mega-Ponzi schemes of the mid to late 2000s, the expansion of domestic and international regulation and the proliferation of professionals dedicated to this fight.

# Fundamental Causes for Fraud

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## Elements Typically Present when Fraud Occurs:

1. Pressure or Motive (greed or need)
2. Rationalization for committing a dishonest act (underpaid, underappreciated or plans to pay it back) or simply possessing a criminal mindset (disregard for the impact of the fraud on others)
3. Opportunity (direct or constructive access to assets, able to circumvent controls and conceal from others)

## *An Important Takeaway ...*

***“Someone with a motive to commit fraud who can rationalize their behavior will often find the opportunity.”***





# 2

## Fraud Prevention and Detection and the Application of Forensic Tools

# Fraud Prevention and Detection

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**“The prevention of fraud hinges on management and internal control designed to limit opportunity and detect aberrations or fraud in the normal course of business.”**

# Fraud Prevention and Detection

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**“The best systems of fraud prevention emanate from all facets of the leadership and management of organizations ... it must begin with an attitude of prevention and detection that is communicated throughout the entity.”**

# Fraud Prevention and Detection

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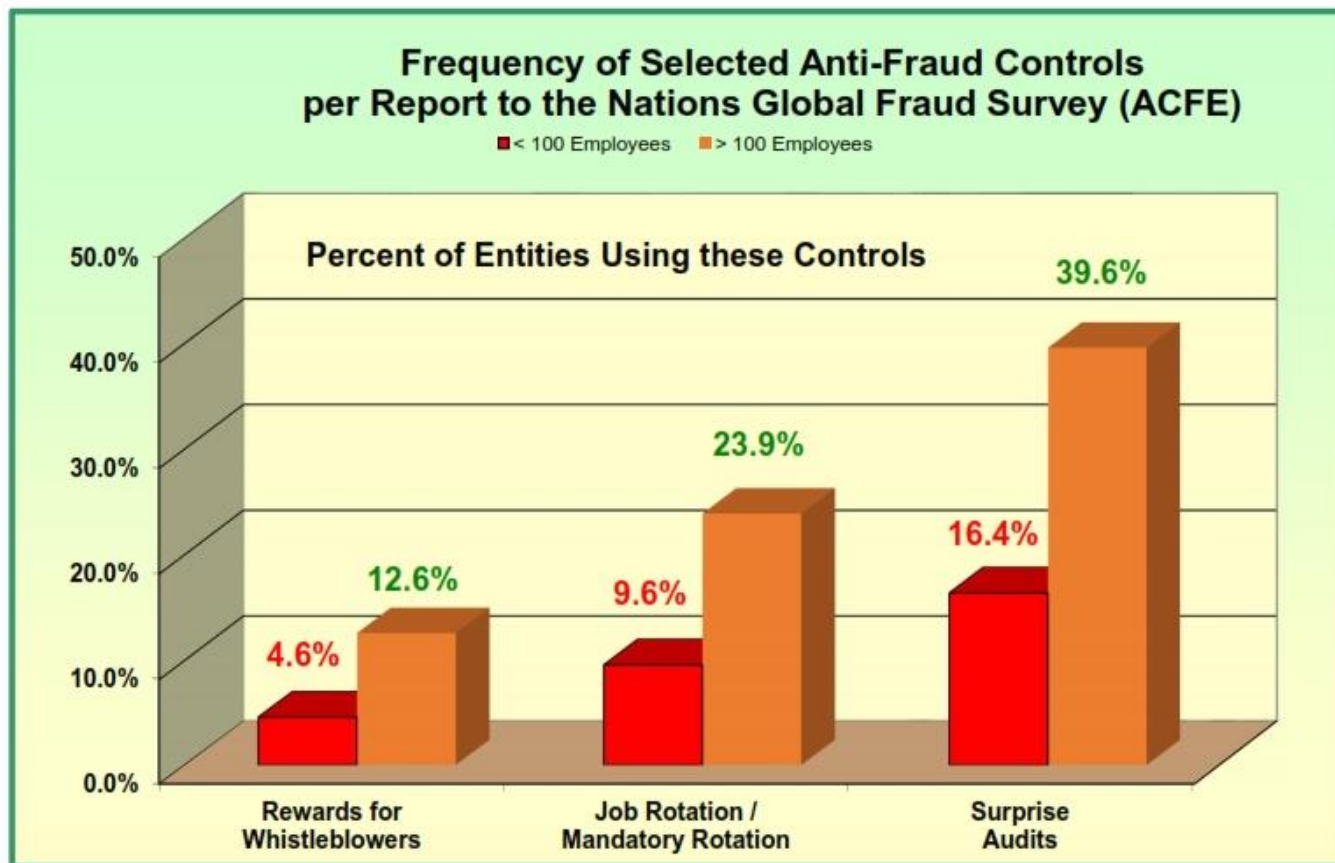
**“The cost of fraud is often more than the dollars lost; it also includes the immeasurable consequences of loss of trust, vulnerability and concern that controls and management are lacking.”**

# Fraud Prevention and Detection

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**“These consequences may have a pervasive affect on operations, which behooves organizations of all sizes to proactively prevent and detect fraud through internal control and specialized techniques to detect aberrations or fraud in the normal course.”**

# Internal Control and Control Environment

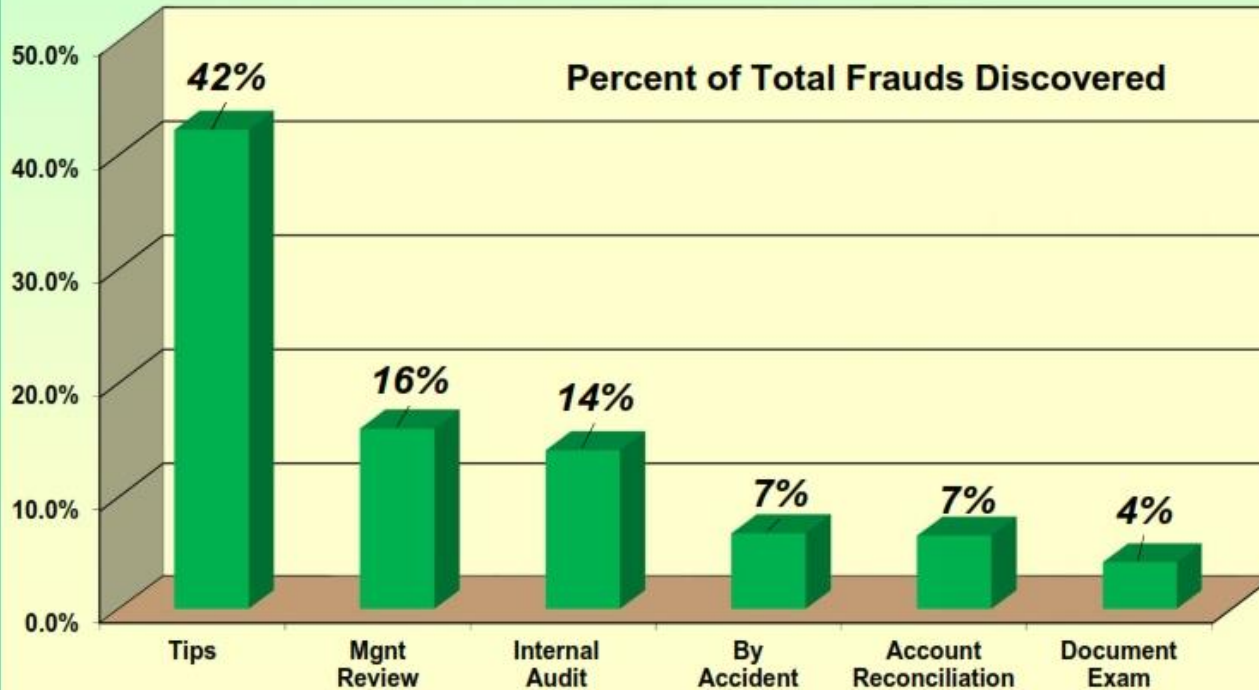


Some of the most effective internal controls are also the least utilized controls by organizations.

# Internal Control and Control Environment

**Frequency of Detection of Fraud  
per Report to the Nations Global Fraud Survey (ACFE)**

■ 2014 Study Results



As evidenced by the most frequent detection methodology, effective internal controls are those that focus on maximizing the probability of discovery.

# Forensic Accounting Tools Used to Analyze Financial Data

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## Forensic Tools

- Information Mining – Inquiries and Document Requests
- Ratio Analysis – Horizontal / Vertical / Benchmarks
- Trend Analysis – Historical / Unusual
- Composite Ratios – Altman Z Score / Beneish M Score
- Statistical Analysis – Linear Regression
- Benford's Law Analytics
- Cash Flow Analytics
- Analysis of Accruals

## Software

- Data Base Uploads / Idea or ACL Analytical Software Tools
- Document Management / Relativity (kCura) / Concordance
- Spreadsheet Functionality / Excel / Access / Formulas
- Downloads and Audit Functions of Accounting Software Databases



# Transaction Implications

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- Two types of fraud within a transaction to be watchful for:
  - **Known**
    - Intentional misstatement of financial results in order to induce a transaction or achieve a higher valuation
  - **Unknown**
    - A scheme operating that even company executives don't know about

# 3

## Transactions and the Foreign Corrupt Practices Act (FCPA)

- I. FCPA defined
- II. FCPA in transactions
- III. FCPA red flags
- IV. Anti-bribery compliance and preventative measures

# FCPA Summarized

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The Act has two main sections:

- **Anti-Bribery:** generally prohibits payments or promise of payments to government officials to gain a business advantage.
  
- **Accounting Provisions:** “issuers” (e.g. publically traded companies) must:
  - maintain accurate accounting records (books and records provision), and;
  - implement internal controls to prevent or detect such payments (internal controls provisions).

*Historically, the Act has been interpreted very broadly.*

# FCPA Defined

## Civil Penalties:

- Corporations: \$500,000 fine/per violation
- Individuals: \$100,000 fine/per violation

## Criminal Penalties:

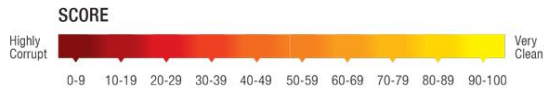
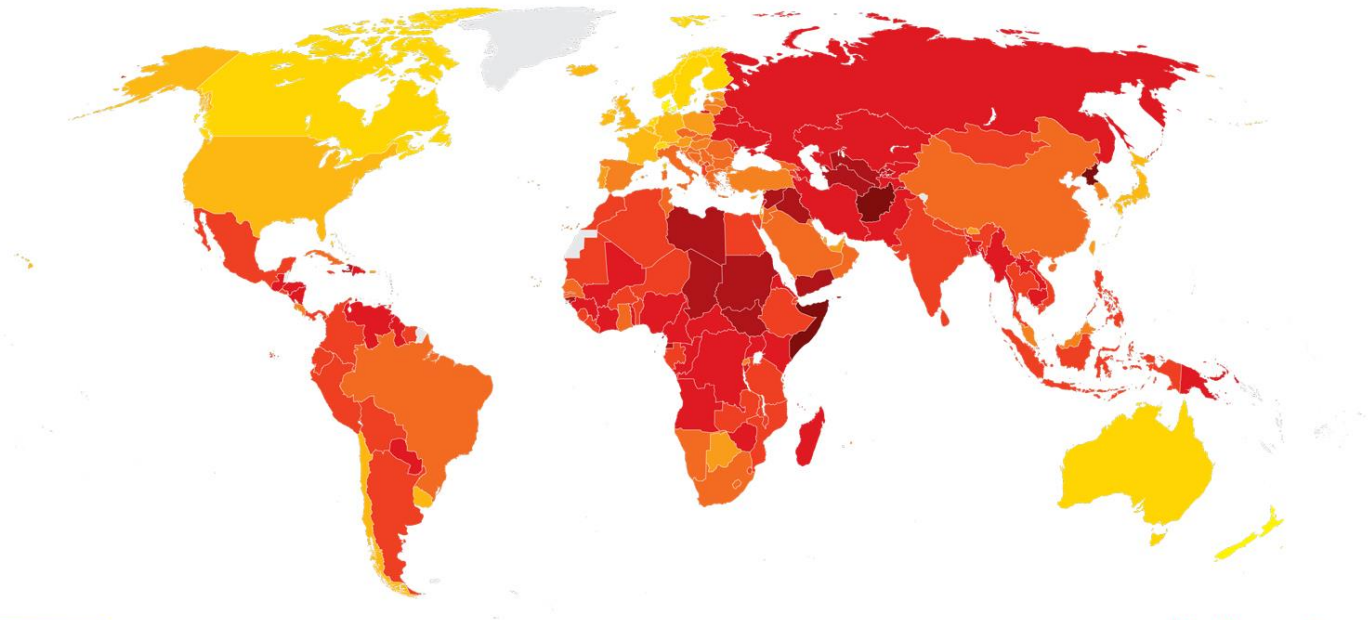
- Corporations:
  - Bribery: \$2 million fine/per violation
  - Books & Records: \$25 million fine/per violation
- Individuals:
  - Bribery: \$100,000 fine
  - Books & Records: \$5 million fine
- Imprisonment:
  - Bribery: 5 year maximum
  - Books & Records: 20 year maximum





# CORRUPTION PERCEPTIONS INDEX 2013

The perceived levels of public sector corruption in 177 countries/territories around the world.



[#stopthecorrupt](#)

[www.transparency.org/cpi](http://www.transparency.org/cpi)

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# Why You Should Be Concerned with FCPA

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- FCPA investigations and enforcement actions by DOJ and SEC at all time high.
- U.S. parent companies are often held liable for the acts of foreign subsidiaries, even where they were not aware of the violations.
- The buyer of an entity inherits the entity's current and past FCPA issues.
  - Halliburton June 13, 2008 requesting FCPA opinion from DOJ on acquisition.
- Corporate executives have been charged criminally for violations.
- Increased scrutiny of “foreign” government partners – particularly in “high” corruption risk countries.
- New sources of information for DOJ and SEC:
  - Voluntary disclosures
  - M&A due diligence
  - Whistleblower complaints (including those of competitors)
  - Court records/contract disputes

# Selected Enforcement Actions

The DOJ and SEC are prosecuting cases in various industries

Enforcement Action	Industry	Geography	Summary of Allegations	Total Fine/Penalty (USD)
SEC v. Siemens Aktiengesellschaft (2008)	Manufacturing	Germany, Argentina, Bangladesh, Venezuela, France, Turkey, China, Nigeria, Vietnam, Russia, Mexico, Iraq	Approximately \$1.4 billion in payments to bribe government officials	\$1,600,000,000
SEC v. Nature's Sunshine Products, Inc., Douglas Faggioli and Craig D. Huff (2009)	Consumer Products	Brazil	Illegal payments made to customs officials	\$650,000
SEC v. Novo Nordisk A/S (2009)	Pharmaceuticals	Iraq	Government kickbacks to the former Iraqi government under the UN Oil for Food Program	\$18,030,145
SEC v. Halliburton Company and KBR (2009)	Oil & Gas	Nigeria	Payments made to Nigerian government officials	\$579,000,000
United States v. AGA Medical Corporation (2008)	Medical Devices	China	Corrupt payments to Chinese doctors in government-owned hospitals	\$2,000,000

# Current Investigations

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As of July 2014, there are 106 ongoing FCPA investigations disclosed by publically traded companies. Some of the names include:

- Accenture plc
- Airbus Group
- Anheuser-Bush InBev
- Avon Products Inc.
- Citigroup
- DHL
- Fedex
- GlaxoSmithKline
- Goldman Sachs
- KKR & Co.
- Halliburton Company
- Hewlett-Packard
- Kraft Foods
- Medtronic Inc.
- Novartis
- Oracle Corp.
- Viacom
- Rolls Royce
- Smith & Wesson
- Sony Corp
- Stryker Corp.
- UBS
- Walt Disney Company
- WalMart



# Red Flag Scenarios in Transactions

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- Acquisitions in highly corrupt countries and/or high-risk industries
- Lack of formal anti-corruption policies or controls
- Doing business in countries with a high risk or history of public corruption
- Significant use or reliance on 3rd party finders / influencers
- Lack of transparency in 3rd party contracts
- Press reports of payoffs and bribes
- Charitable contributions in foreign jurisdictions
- Sales to foreign government agencies
- Request for commission payments to other country
- Excessive payments for services rendered
- Vague deliverables in contracts
- Unusual payment terms
- Unnecessary involvement of agents in transactions

# Evaluate FCPA Risks in transactions

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Take a critical look at your current FCPA exposure in a potential transaction.

- Does the target operate in countries which are high risk for corruption? (e.g. lower scores on the TI index)
- Does the target do business directly with foreign governments or have a business subject to direct regulation by foreign governments? (e.g. permits, import restrictions, duties and taxes, etc.)
- Does the target utilize joint venture structures in foreign countries?
- Does the target rely extensively on agents or representatives when operating abroad?
- Does your own company's due diligence process fully consider the impact of FCPA?
- Does your transaction evaluation quantify or consider mitigation of potential FCPA exposure?

# FCPA Best Practices

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- Identify target's high risk transactions and activities.
- Utilize pro-active data analytics tools to surface unusual transactions for further review.
- Survey the affected employees to gauge their understanding and identify holes and gaps in their knowledge.
- Design your process with depth and breadth so as to catch transactions which may not ultimately be FCPA issues.

# Identifying FCPA Issues Through Forensic Techniques

- Analysis of high-risk general ledger accounts
  - Payments to professional service providers
  - Charitable contributions and political donations
  - Payments for gifts, travel and hospitality provided to foreign officials
  - Commissions (identify additional agents and consultants not previously identified)
  - Marketing (support for expenditures)
  - Consulting
  - Bonuses
  - Education (reimbursement of US and foreign education for foreign officials)
  - Payments to agents, such as travel agents, import & export agents, etc.
- Review of expense reports of high-risk employees
- Petty cash activity and cash advances
- Significant write-offs of Accounts Receivable
- Evaluation of tax, environmental or other disputes with governmental agencies



## Key Takeaways

# Key Takeaways

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A few lessons learned or recommendations going forward:

1. Fraud prevention is an attitude that flows from leadership
2. Study the controls and control environment carefully in that this is the way to limit opportunity to commit fraud (consider effectiveness, functionality and costs of internal controls)
3. Use forensic tools as a way to augment the control environment with specialized detection methodologies (forensic tools)
4. Focus on the tools that are most effective
5. Remember, the acquirer inherits all FCPA and import/export issues, and would be held accountable by DOJ/SEC/State departments
6. Incorporate FCPA and import/export anti-fraud and anticorruption compliance programs within M&A due diligence procedures



# Questions

## Thank You

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