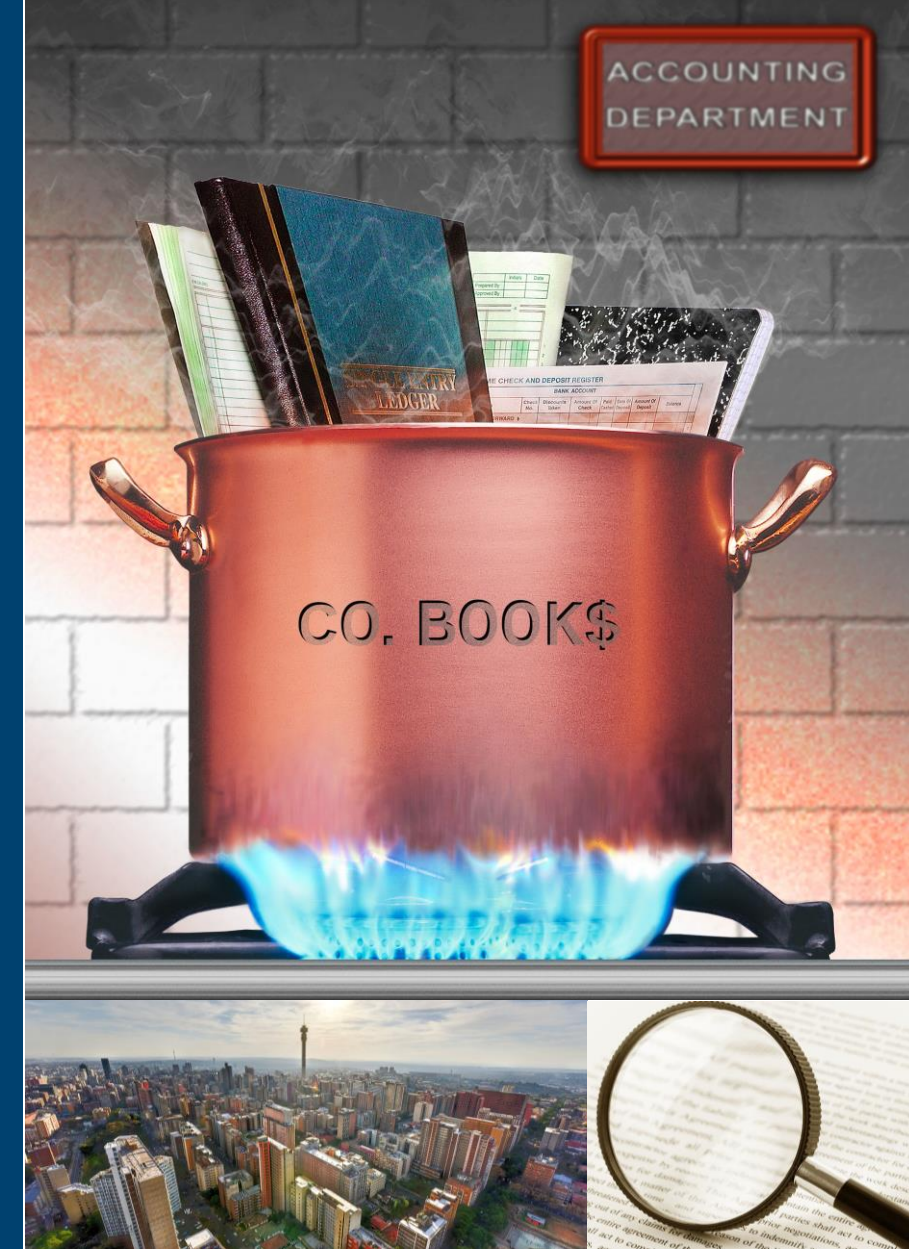


Cooking the Books: *How to Spot the Chef, the Cook and the Cleaners* A U.S. Perspective

Simon Platt
Presentation to the
Institute of Commercial
Forensic Practitioners
13 May 2019



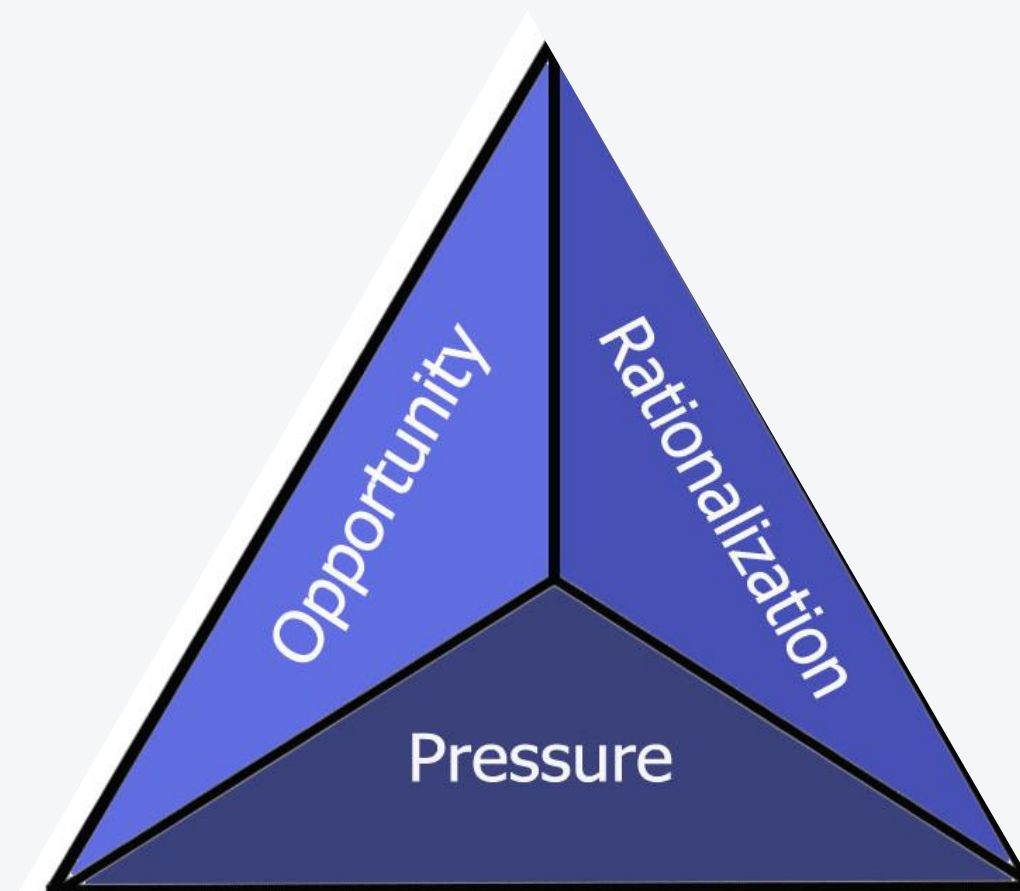
StoneTurn



Agenda

- Defalcations
- Cooking Books
- Response
- Investigations
- Enforcement
- Data Analytics Tools

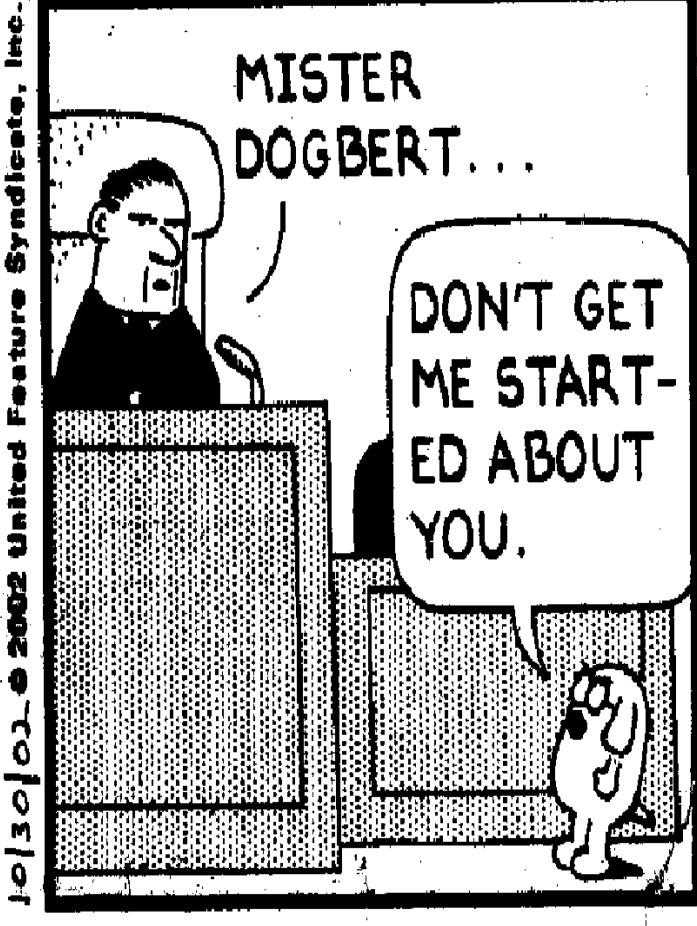
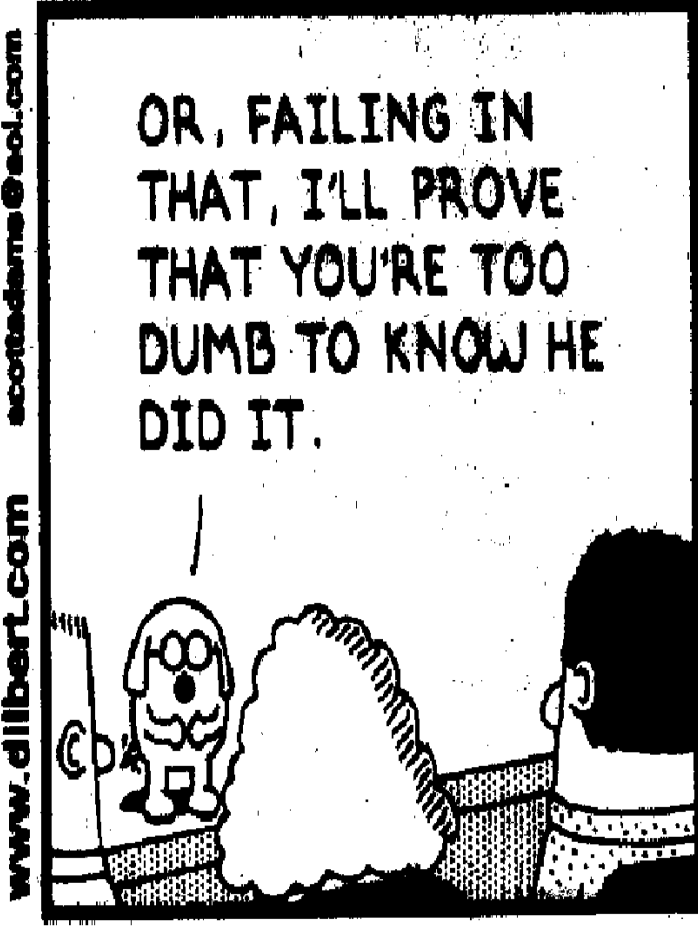
The Fraud Triangle



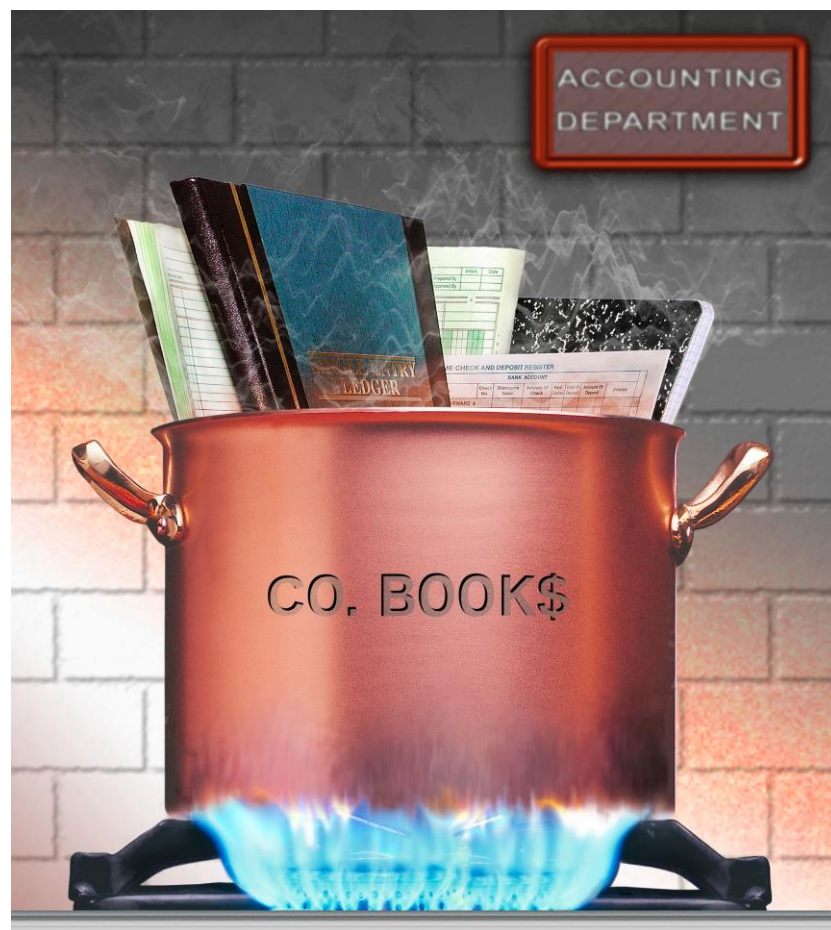
Source: Donald R. Cressey, *Other People's Money* (Montclair: Patterson Smith, 1973)

We Didn't Mean It

DILBERT By SCOTT ADAMS



Defalcation / Theft of Corporate Assets



Potential Flags

- Long-term, trusted employee
- Informal “authority”
- Reconciliations
- System deficiencies / transitions

“Cooking the Books”: What to Watch For

Motives

- ❑ Achieve or beat investor expectations
- ❑ Manage or “smooth” earnings
- ❑ Hide bad news
- ❑ Inflate value of a division, subsidiary or segment
- ❑ Facilitate stock or bond offering
- ❑ Increase stock price or executive compensation

Risk Factors

- ❑ Aggressive accounting policies, earnings or revenue forecasts
- ❑ Undue emphasis on achieving quarterly results or non-GAAP metrics
- ❑ Disclosures that lack transparency
- ❑ Transactions that lack economic substance or done to achieve an accounting result
- ❑ Compensation linked to financial metrics
- ❑ Creeping effect

How Companies Can Prepare: Accounting Controls

Books and Records

- Understand common methods for hiding and recording improper payments
 - Consulting fees, commissions, travel & entertainment expenses

Internal Controls

- What key controls are in place relating to cash disbursements and employee expenses?
- Design
 - Are controls designed to prevent or detect improper payments?
 - Have walkthroughs been done?
 - Has override or circumvention been addressed?
 - Have cyber-fraud risks been considered?
- Operating Effectiveness
 - Are relevant controls working effectively?
 - Have they been tested by internal audit or compliance?
 - What deficiencies have been identified?
 - What enhancements can be made?

Common Threats Faced by Companies Today

- While all companies face these types of risks, small-to-mid-size companies are particularly vulnerable as they often have fewer controls and compliance procedures in place
- Controls are only as good as the people who monitor them
- Educating the four lines of defense -- Operations, Legal, HR and Finance -- should be an ongoing priority
 - What are the red flags to look for?

Best Practices for Companies

Proactive

- ❑ Strong audit committee
- ❑ Adequately staffed accounting compliance and internal audit departments
- ❑ Clear accounting and disclosure policies, procedures and documentation
- ❑ Clear ethics and anti-bribery policies, procedures and documentation
- ❑ Clear, robust internal controls and disclosure controls
- ❑ Robust no capital, risk assessments
- ❑ Testing and monitoring of controls
- ❑ Adequate training—in foreign language
- ❑ Whistleblower/Ethics hotline

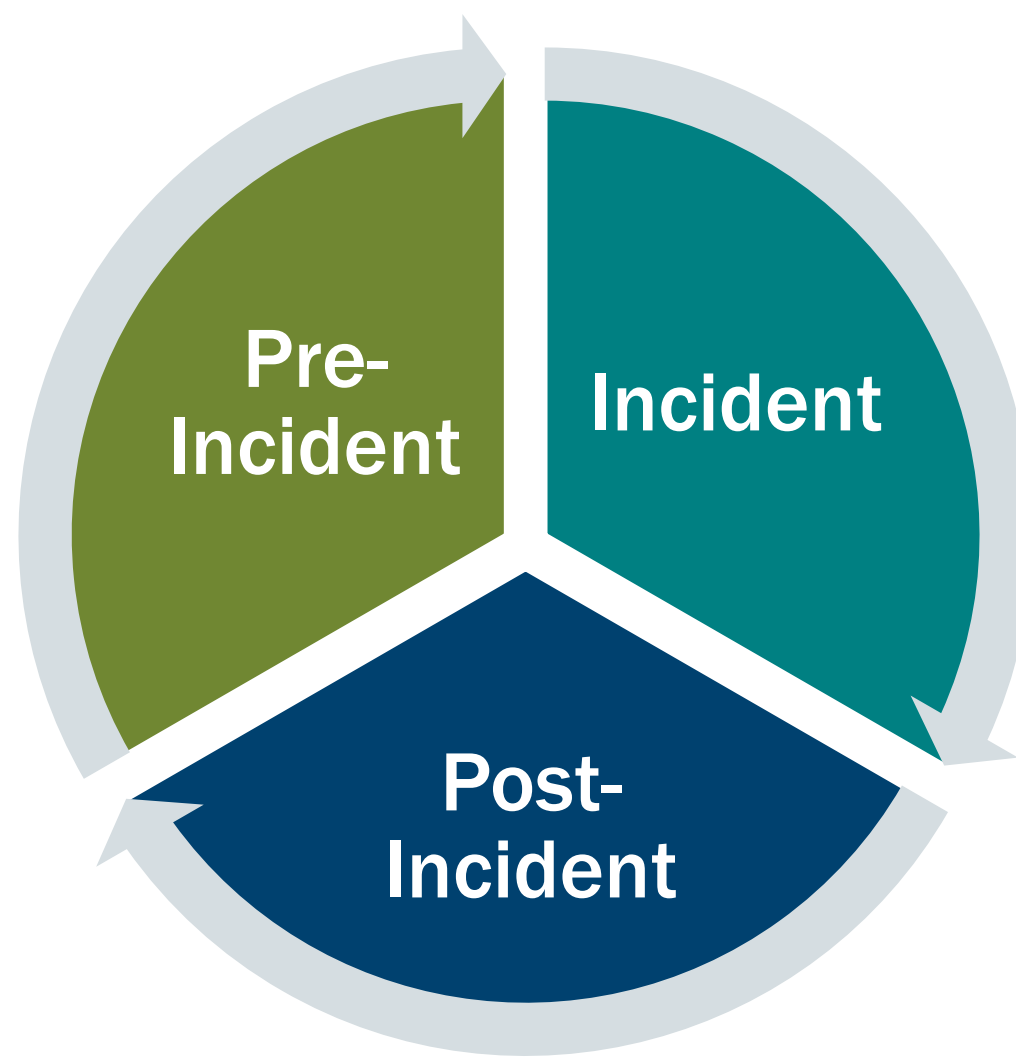
Reactive

- ❑ Prompt investigation of issues
- ❑ Follow-up with appropriate resources to allegations, regardless of source
- ❑ For accounting matters, consideration of qualitative materiality factors
- ❑ Consideration of government's expectations (e.g., self reporting and cooperation)
- ❑ Ceasing improper conduct and taking disciplinary actions
- ❑ Prompt remediation or enhancement of controls

How Can Companies Mitigate the Risk and Maximize the Benefit of “Corporation as Cop”?

Compliance

- Assess Baseline Program
- Identify Risks
- Link Controls
- Forensic Business Review
- Address Deficiencies



Investigation

- Integrate Risk Rating Model
- Re-assess Compliance Program
- Commence Remediation

Remediation & Monitoring

- Start Sooner!
- 3 R's: Root Cause, Read Across, Repair Deficiencies
- Monitors: Avoid, Prepare, Liaise

Developing a Response Plan

- What steps should in-house lawyers and outside counsel take when financial improprieties are uncovered? Have a response plan in place:
 - Involve outside advisers:
 - Historical outside counsel vs. truly “independent” counsel with no prior relationship – Pros and cons to both approaches
 - Utilize In-house counsel:
 - Should take prompt action to secure potentially relevant documents and prevent destruction of relevant evidence
 - Coordinate with counsel, IT, forensic accounting, and/or audit personnel
 - Helps to position the company well in the eyes of regulators and avoid costly missteps

Developing a Response Plan

- Response plan – Other considerations:
 - Carefully consider who should be involved
 - Protect the integrity of the company's investigation by closely circumscribing the number of people aware of the investigation
 - Work closely with outside advisers who have expertise and can help to ensure that relevant information is obtained while protecting the defensibility of investigatory procedures

Common Issues for Consideration

- Choosing outside counsel (timing and who to retain)
- Hiring attorneys for individuals
- Self Reporting
- Public disclosure
- Delay tactics
- Failure to work with staff on information requests
- Incomplete/limited scope investigations
- Partial stories
- Failure to consult OCA or Corp Fin prior to restatement
- Improper or non-use of accounting expertise

Conducting Effective Internal Investigations – Remediation Efforts

- Begins soon after the discovery of the issue(s)
- More than a disclosure item
 - Definitive actions and actual implementation
 - Appropriate personnel and independent assistance
 - Incorporate plans to monitor and assess status and progress
 - Specific issues addressed; broader ethics & compliance program must provide the platform
- Expect regulator requests for status updates, detail
 - SEC enforcement continues to view internal controls/compliance violators as a focus
 - Monitoring arrangements

Enforcement Landscape in the U.S.

High expectations for:

- ✓ Maintaining an effective compliance programs to prevent, deter and detect fraud
- ✓ Identifying control deficiencies and remediating them in a timely manner
- ✓ Investigating internal whistleblower complaints and disciplining wrongdoers
- ✓ Self-reporting violations to the government
- ✓ Cooperating with the government in connection with enforcement inquiries

Ongoing efforts to:

- ✓ Enhance data analytic capabilities to proactively identify fraud
- ✓ Encourage whistleblowers to report violations either internally or directly to the government
- ✓ Boost accounting and FCPA prosecutions, especially those involving internal controls and disclosure controls
- ✓ Hold individuals responsible for Company violations even if for non-fraud books and records and controls violations

Higher cost to resolve:

- ✓ Parallel investigations and cooperation with other regulators (DOJ and foreign)
- ✓ Large monetary payouts for disgorgement and penalties
- ✓ Imposition of Monitors
- ✓ Increased willingness to litigate matters
- ✓ Non-prosecution or deferred prosecution resolutions, in some cases, versus total pass
- ✓ Seek admissions in certain matters

Risk Factors for Becoming the Subject of an SEC Enforcement Inquiry

Accounting

- Restatement
- Material Weakness reported
- Change in auditors or senior management
- Vague or complex disclosures
- Large contingencies or impairment charges
- Suspicion of earnings management or manipulation of non-GAAP metrics

FCPA

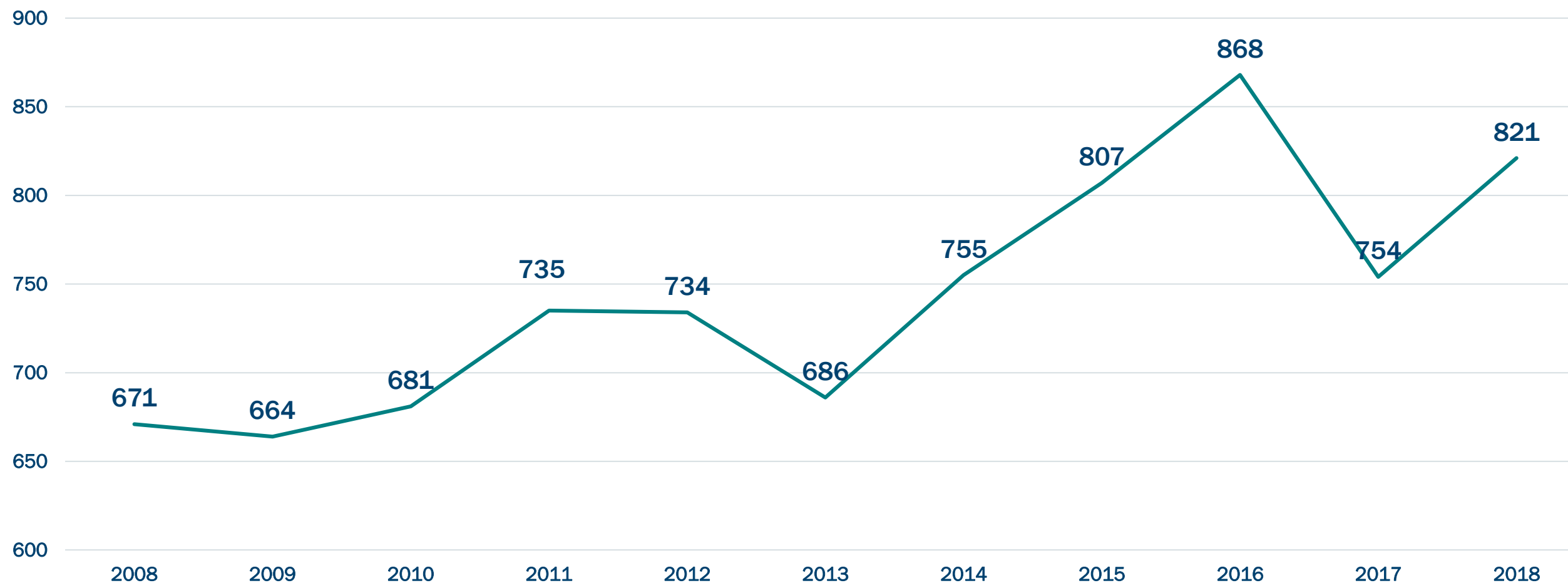
- Press articles discussing corruption
- Whistleblower allegations
- Competitor under investigation

General

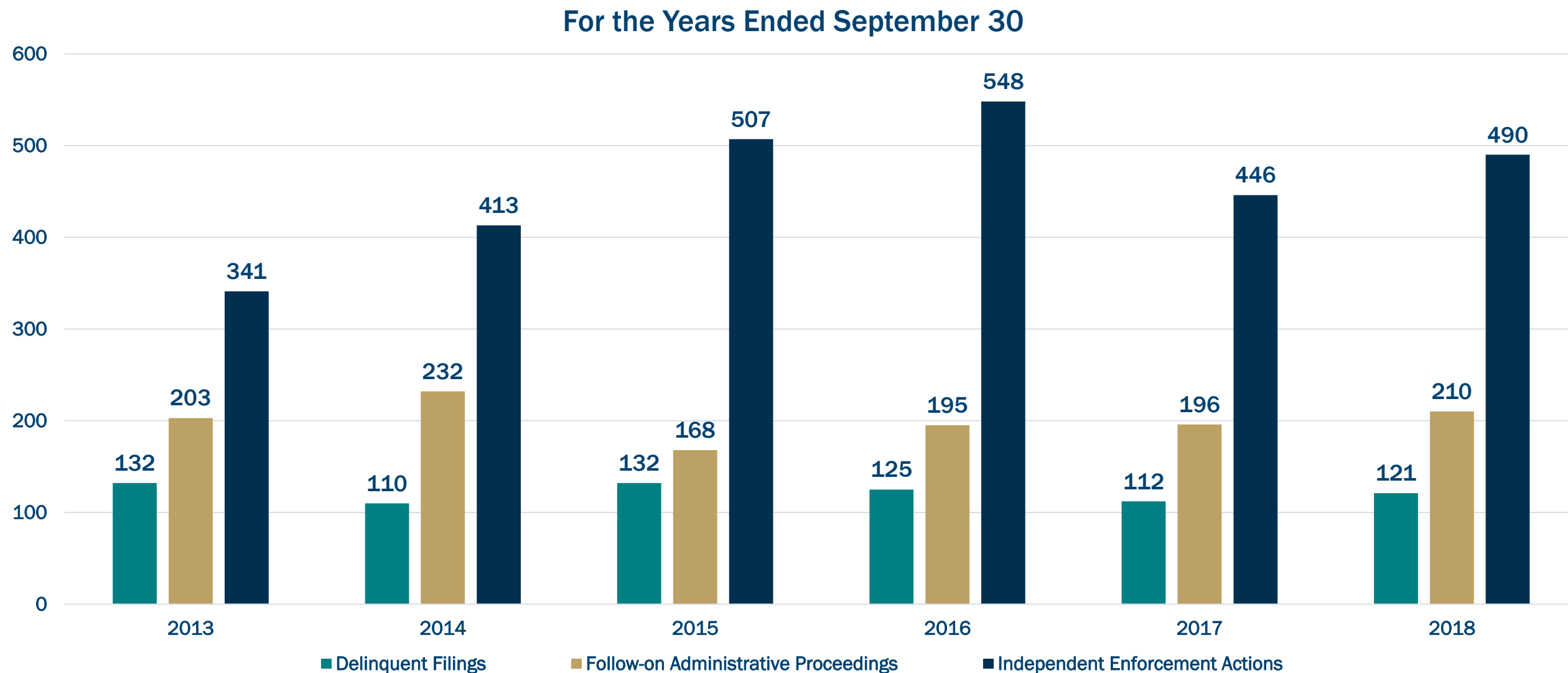
- Referral from other SEC Division, SRO (NYSE, NASDAQ, FINRA), or foreign regulator

A Decade of SEC Enforcement Actions

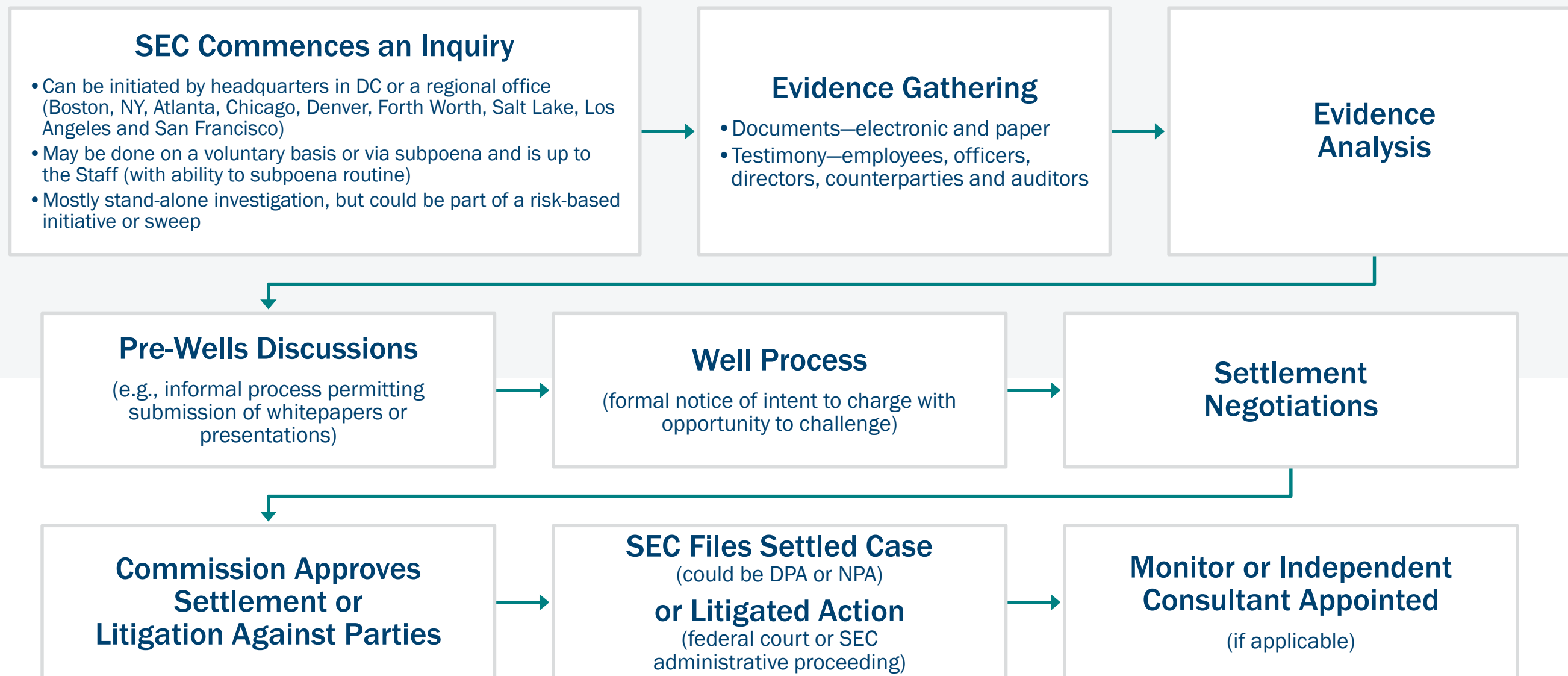
Total SEC Enforcement Actions
For the Years Ended September 30



SEC Independent Enforcement Actions



SEC Investigation Process: What to Expect



Whistleblowers

- The Office of the Whistleblower program awarded over \$168 million to 13 whistleblowers in fiscal year 2018, which is more than the total paid 2012 - 2017
- The Dodd-Frank Whistleblower program began in August of 2011 and has paid out over \$326 million to 59 whistleblowers since its inception
 - March 2018: Awarded approximately \$83 million to three individuals
 - September 2018: Awarded more than \$54 million to two individuals



Data Analytics and Fraud Detection

- For years, investigation teams have used data analytics as part of their work plans
- We see more companies using data analytics as part of pre-incident compliance programs, i.e., transaction monitoring
 - to identify and flag specific issues either as part of periodic internal audits or on a real-time basis.
 - to enhance the data analytic exercise by visualization tools (e.g., Tableau, PowerBI or even Excel) to assist in spotting trends or anomalies.
 - to make the process more streamlined, organized and consistent.
 - for real-time data analysis, which would likely be on the back-end data with a programmatic solution, like SQL or Python, to raise red flags for subsequent manual review.
 - to incorporate various data sources such as trading, sales, transactional, CRM, time keeping, accounting, inventory, expense detail, etc. For example, there is definitely a push in the pharma industry by the DOJ for proactive data monitoring

Data Analytics and Fraud Detection

- As part of post-incident internal investigations, data analytics typically is more targeted toward the specific allegations, e.g., FCPA, employee misappropriation
 - Utilize both visual and programmatic analyses (using similar tools as above) to understand the data, with the goal not only of identifying fraud, and to assist in the direction of the investigation, e.g., certain time periods, vendors, geographic locations, but perhaps more importantly, on determining the relative impact, as well as synthesizing the nature/extent of the issues for the regulator or management
- Recently, we've found that regulators, such as the SEC, are much more data savvy. So, not only are they making requests for larger datasets, but also expect corporation to (i) be able to produce the requested data in an accurate and orderly fashion, and (ii) be able explain and analyze their own data.
- Considerations and risks before adopting a data analytics program

Thank You!



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