Typical forensic accountant roles in anti-corruption due diligence

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Given the continued focus on the importance of assessing corruption risks in the context of mergers and acquisitions by the US Department of Justice and the Securities and Exchange Commission, as demonstrated through continued enforcement efforts as well as the joint November 2012 "Resource Guide to the U.S. Foreign Corrupt Practices Act" (the Guide), the question is often posed to forensic accountants:

"What is the role of forensic accountants in performing anti-corruption due diligence versus the role of attorneys?"

This question can best be answered by considering the typical phased approach to performing anti-corruption due diligence. In this context, certain phases involve both the forensic accountants and legal counsel, in addition to the company itself, and other phases might involve only the forensic accountants. The typical phases of anti-corruption due diligence include:

- Anti-corruption risk assessment
- Anti-corruption due-diligence procedures
- Enhanced procedures surrounding corruption red flags
- Development of a post-closing anti-corruption compliance program

The anti-corruption risk assessment phase is typically a joint effort among the company, its forensic accountants and its external legal counsel. Data room information and publicly available information regarding the target may have different legal and accounting ramifications. A joint effort to establish the scope of the diligence procedures is key to avoiding a "cookie cutter" approach and instead allowing the scope of the diligence to focus on areas of perceived risk.

The anti-corruption due diligence procedures phase can generally be broken down into three primary areas: interviews, transaction records testing and electronic data review. Interviews are typically a joint effort of external legal counsel and the forensic accountants. The transaction records review is the focus of the forensic accountants, especially when you consider the type of information being analyzed. Such procedures may include detailed analysis in the following areas:

- Analysis of target financial information to identify trends outliers, and potential corruption red flags. This could include analysis of third-party payments, distributor margins, expenses involving gifts and entertainment, and promotional spend. Additional analysis around sales data to isolate specific target sales locations and customers that could present corruption risk based on geography or industry may warrant consideration.
- Assessment of target's sales channels to detect higher opportunities for corrupt activity. Typically, sales through third-party sales intermediaries, such as sales representatives or agents, for example, would present a higher corruption risk than sales through a direct employee sales force. Statistics suggest that a majority of recent enforcement actions involve the use of third-party sales intermediaries.
- Assessment of target's internal controls for high-risk activities specifically related to the client's industry, known industry risks and target's key operating locations to isolate potential control gaps. Examples may include controls around the following areas: cash activities and petty cash, entertaining and gift giving, political contributions, charitable donations, payments to third parties, due diligence on third parties and sponsorship activities.
- Performance of background research on the target, the target's key management and any major third-party vendors or partners for negative media, government actions (investigations, convictions, settlements), and government connections using publicly available and proprietary databases to detect potential corruption red flags.

The source of information used in the transaction records analysis process will include not only direct accounting support such as ledgers and journal vouchers, but also contracts, litigation files, board meeting minutes, management representation letters, internal audit reports, etc., many of which may necessitate teaming with external legal counsel after their analysis of such documents.

The third phase typically involves performing enhanced procedures surrounding red flags identified in phases one and two. This phase often requires a deeper analysis of available information and further transaction testing to determine if prohibited conduct is occurring. Therefore, these enhanced procedures are typically performed by the forensic accountants. Payments to third parties, detailed analyses of gifts and entertainment, petty cash, charitable contributions, political donations and payments to third-party sales intermediaries are often tested on a detailed basis, and typically require significant access to and understanding of accounting records and processes. These procedures may include detailed steps, such as the following examples of accounting-based analyses:

- Test a broader sample of high-risk activities (e.g., payments to agents and high-risk vendors, analysis of cash activities (including petty cash), analysis of travel and entertainment reports, analysis of gift giving and entertainment involving government officials, analysis of payments to freight forwarders, analysis of contract bid activities) to analyze stated controls and to assess potential impact of the buyer's controls on the target's future performance.
- Perform further analysis on the target's key management and third-party vendors and partners for negative media, government actions (investigations, convictions, settlements) and government connections, focusing on previously identified red flags.

The fourth phase typically involves developing an anti-corruption compliance program post-close. This phase is typically a joint effort among the company, its outside legal counsel and its forensic accountants to address compliance standards, procedures and training reasonably capable of reducing the prospect of corruption risk based on the information obtained through the due-diligence process.

The aforementioned Guide points to specific examples where anti-corruption due diligence and post-acquisition efforts resulted in the government's decision not to prosecute successor companies for pre-acquisition violations. In situations where pre-acquisition due diligence is not possible, the Guide highlights the need to conduct post-close procedures to achieve the same goal: identification of corruption risks at the newly acquired entity.

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About the authors


Wolski


Adams

This paper was written by **Greg Wolski** and **Virginia Adams**. Greg is a partner and the leader of Ernst & Young LLP's Transaction Forensics team within its Fraud Investigation & Dispute Services practice. He can be reached at gregory.wolski@ey.com or +1 312 879 3383. Virginia Adams is a Partner on Ernst & Young LLP's Transaction Forensics team. She can be reached at virginia.adams@ey.com or +1 212 773 7475.

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