The program will begin at 2 p.m. EST
Wednesday January 22, 2014

Detecting fraud in consumer products companies: Real stories in the marketplace

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Detecting fraud in consumer products companies: Real stories in the marketplace

January 22, 2014
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Housekeeping

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- Log in to the webcast with your first and last name and e-mail address
  - For attendees participating in a group, designate one proctor to log in as an individual on behalf of the group, then complete and submit the group sign-in form within 24 hours of the event’s conclusion. The form can be downloaded by clicking the Handouts icon on the toolbar at the top of your screen.

- Participants/proctors must remain on the webcast for a minimum of 50 minutes to receive credit

- Participants—and proctors on behalf of a group—must answer polling questions (75% participation required)
  - To answer a polling question, click on the radio button to the left of the answer you’d like to choose. You do not need to have the correct answer but must participate to receive credit. Once each poll closes, participants will no longer be able to respond to that question.

- 1.0 CPE credit will be issued to eligible participants within 60 days

- NASBA will not issue credit if all criteria is not met, without exceptions
McGladrey consumer products focus

- McGladrey serves over 4,600 consumer products companies from across the country
- Specialty practices include food and beverage, retail and apparel
- To sign up for our monthly retail industry commentary or learn more about our industry focus, visit our website at http://mcgladrey.com/content/mcgladrey/en_US/what-we-do/industries/consumer-products.html
- For more information on financial advisory services, visit http://mcgladrey.com/content/mcgladrey/en_US/what-we-do/services/financial-advisory.html

Carol Lapidus
Assurance Partner
National Consumer Products Industry Leader
212. 372.1272
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Poll Question #1

Which best describes your company’s industry?

a) Apparel/textile/accessories manufacturer, wholesaler or distributor
b) Other consumer products manufacturer, wholesaler or distributor
c) Retailer (non-food)
d) Food and beverage distributor
e) Food and beverage retailer/restaurant
f) Other
Today’s presenters

Carol Lapidus
Assurance Partner
Consumer Products Industry Leader
McGladrey LLP

Joseph Decilveo
Partner
Financial Advisory Services Leader
McGladrey LLP

Mary J. Kreidell
Director
Financial Advisory Services
McGladrey LLP

Scott Richter
Director
Financial Advisory Services
McGladrey LLP
Agenda

- Anti-Corruption Laws and Fraud Risks Associated with Global Businesses
  - Overview of global anti-corruption laws and FCPA
  - Dodd-Frank whistleblower provisions
  - FCPA enforcement and penalties
  - DOJ/SEC Resource Guide
  - Effective compliance programs – Process and best practices

- Third Party Intermediaries - Understanding who they are and how they may pose a threat

- Fraud Scenarios – Recent trends and early detection strategies

- Immediate Next Steps if a Potential Fraud is Detected
Timeline of Major Global Anti-Corruption Laws

1977  U.S. Foreign Corrupt Practices Act (FCPA)
1997  Organization for Economic and Cooperative Development (OECD) Anti-Bribery Convention
1998  U.S. International Anti-Bribery Act (FCPA broadened)
2010  U.K. Bribery Act (Enactment)
2011  8th Amendment to the Criminal Law of People’s Republic of China
2011  U.K. Bribery Act (Implementation)
2012  DOJ / SEC’s Joint Resource Guide on the FCPA
Overview of the FCPA – Provisions

**Anti-Bribery Provisions**

- Prohibits U.S. person, U.S. company or any other person in the U.S. from corruptly paying or offering to pay anything of value directly or indirectly to a foreign official to:
  - Secure an improper advantage
  - Influence a foreign official in his official capacity
  - Induce him to violate the law
  - Assist in obtaining, directing or retaining business

- Proof of actual knowledge of a payment or promise to pay is not required

**Accounting Provisions**

- Requires SEC-registered or reporting issuers maintain books, records and accounts in reasonable detail that accurately and fairly reflect transactions and dispositions of assets and implement adequate system of internal accounting controls

- No materiality standard
Overview of the FCPA – Jurisdictional Reach

### Anti-Bribery Provisions
- Issuers
- Officers, directors and employees of Issuers
- Foreign nationals and entities (including agents) that commit an act in the U.S.
- Domestic Concerns (individuals/entities)

### Accounting Provisions
- Issuers
- Individual officers, directors and employees of issuers
- Subsidiaries, joint ventures and affiliates owned and controlled (more than 50% voting power) by the issuer

- The International Anti-Bribery Act of 1998 expanded FCPA jurisdiction such that territorial nexus is no longer required
IRS Involvement in FCPA

- If a taxpayer admits to making payments that violate the FCPA, amendments to their returns may need to be filed, giving rise to potential civil penalties and interest.

- Improper deductions of payments that violate the FCPA’s anti-bribery provisions can result in civil penalties imposed by the IRS.

**Accuracy Related**

- 20% of underpayment

**Fraudulent Filings**

- 75% of underpayment
Dodd-Frank Act - Whistleblower Provisions

- Final rules became effective on August 12, 2011
- FCPA investigations in the past have been heavily dependent on self-reporting by companies
- Dodd-Frank Act Whistleblower Provisions could result in a significant increase in the number of FCPA investigations:
  - Qualifying rewards equal to 10 to 30 percent of total recoveries
# FCPA Enforcement and Penalties

## Anti-Bribery Provisions

<table>
<thead>
<tr>
<th>Criminal</th>
<th>Civil</th>
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<tbody>
<tr>
<td><strong>Individuals</strong></td>
<td></td>
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<tr>
<td>- <strong>Imprisonment</strong>: up to 5 years for each conspiracy and substantive count</td>
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<tr>
<td>- <strong>Fines</strong>: up to $250,000 or twice the pecuniary gain from the offense or twice the loss to the victim</td>
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<td><strong>Corporations</strong></td>
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<tr>
<td>- <strong>Fines</strong>: up to $2 million per violation or twice the pecuniary gain from the offense or twice the loss to the victim</td>
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<tr>
<td><strong>Civil</strong></td>
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<tr>
<td>- <strong>Fines</strong>: up to $50,000 for individuals and $500,000 for business entities</td>
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<tr>
<td>- Debarment from contracting with U.S. government</td>
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## Accounting Provisions

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<tr>
<th>Criminal</th>
<th>Civil</th>
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<tr>
<td><strong>Individuals</strong></td>
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<tr>
<td>- <strong>Imprisonment</strong>: up to 20 years for willful violations</td>
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<tr>
<td>- <strong>Fines</strong>: up to $5 million</td>
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<td><strong>Corporations</strong></td>
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<tr>
<td>- <strong>Fines</strong>: up to $25 million per willful violation</td>
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<td><strong>Civil</strong></td>
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<tr>
<td>- <strong>Fines</strong>: $100,000 for individuals or the gross amount of pecuniary gain and $500,000 for organizations or the gross amount of pecuniary gain</td>
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<tr>
<td>- <strong>Disgorgement of gains</strong> (including interest)</td>
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2011 saw the 2nd highest number of FCPA enforcement actions in history
22 of the DOJ actions in 2010 stem from a single industry sweep at a Las Vegas military and law enforcement products trade show
Beyond penalties, FCPA investigations alone can be costly:
- e.g., Weatherford International & News Corp. each recently disclosed spending well over $100 million on FCPA investigations
Global Corruption Law Compliance Report*
Findings - Key Themes

- Surveyed middle-market companies, particularly smaller ones, say they have more work to do to effectively respond to global corruption risks.
- Executives say the level of monitoring and self-policing activity taking place today is higher than three years ago.
- Executives rank non-financial obstacles above financial ones as a challenge in addressing global corruption risks.
- Third-party due diligence and monitoring and M&A activity continue to be major sources of global corruption risk.
- Regular training remains an area of opportunity for companies to improve their corruption law compliance.
- New whistleblower provisions in the Dodd-Frank Act increase the stakes and regulatory risks for FCPA compliance.

* Jointly published by McGladrey LLP and the Institute of Internal Auditors
In November 2012, the DOJ and SEC jointly issued *A Resource Guide to the U.S. Foreign Corrupt Practices Act* ("FCPA").

Although the guidance did not really break any new ground, it does serve to consolidate 35 years of precedent and best practices that have arisen over time.

With respect to FCPA Compliance, the guidance identifies ten (10) “Hallmarks of Effective Compliance Programs.”
10 Hallmarks of Effective Compliance Programs

Tone at the Top

Training and Continuous Advice

Incentives and Disciplinary Measures

Third-Party Due Diligence and Payments

Code of Conduct

Oversight, Autonomy, Resources

Risk Assessment

Confidential Reporting, Internal Investigation

Continuous Improvement

Mergers and Acquisitions
Is your anti-corruption actually working? Some questions you should ask:

• What are your specific corruption risks, and how vulnerable are you?
• Have you defined the term “foreign official” in the context of your business?
• Are your internal controls proportionate to the pressures faced by your employees and third-party representatives?
• How are other organizations addressing similar challenges?
• What proactive steps should you be taking to confirm the program is working?
Polling Question 1

A clearly articulated policy against corruption that is committed to by senior management is an example of:

A. Oversight
B. Risk assessment
C. Tone at the top
D. Code of Conduct
Third Party Intermediaries
Risk, Due Diligence and Compliance
Third Party Intermediary - Definition

- A third party intermediary assists the company in some aspect of its foreign business and often includes sales agents, distributors and brokers.

- Intermediaries can also include those acting in an advisory or advocacy role such as lobbyists, attorneys and consultants.

- The FCPA defines an intermediary as any agent of the company; the UK Bribery Act is broader and extends the definition to any person associated with the company.
Risks of Using Third Party Intermediaries

- Ninety percent of FCPA cases brought by the U.S. government involve conduct by third parties (source: Association of Corporate Counsel).
- A company need not have had intent or knowledge of bribery on the part of a third party intermediary in order for the company or individuals to be criminally and/or civilly prosecuted under the provisions of the FCPA or UK Bribery Act.
- A company has less control over the actions of third party intermediaries.
- Company’s should maintain heightened awareness if doing business with government representatives, particularly in higher risk countries such as China.
Third Party Intermediaries: Risk, Due Diligence and Compliance

Conduct Due Diligence

- Background searches (criminal; business) and other third party risk assessment tools.
- Local investigation of third party for reputation and business practices.
- Due diligence should also apply to joint venture partners.

Ensure Compliance

- Ensure that third parties are aware of and comply with local laws, as well as the company’s policies and procedures, ethics, and code of conduct.
- Conduct anti-corruption training with third parties.
- Require contracts and ability to audit third parties with which the company does business internationally.
Polling Question 2

A third party intermediary generally doesn’t include the following:

A. Sales Agent
B. Consultant
C. Government Official
D. Lobbyist
E. None of the Above
Fraud Scenarios

Recent Trends and Early Detection Strategies
Recent Trends:
Theft and Embezzlement

- Controls over cash have generally improved; we are not seeing as many embezzlement cases where employees have been able to write checks to themselves or establish phony vendors (better segregation of duties).

- Recent cases have involved company credit cards used for personal or other unauthorized expenses as a means to embezzle funds from companies.

Case A
- Employee submits and processes his/her own personal credit card bill through the company’s accounts payable system.

Case B
- Employee incurs personal charges on a company-paid credit card.

Case C
- Employee issues corporate cards in the entity’s name – real life example of $5 million in online gambling charges.
Early Detection Strategies

- Enhance quality and frequency of review and approval process (e.g., ensure that immediate supervisor reviews any company-paid credit card expenses before credit card is paid).

- Identify any segregation of duties issues in the accounts payable function.

- Perform periodic or monthly review of cash disbursements and vendors.
Recent Trends: Financial Statement Fraud

- Financial statement fraud is still prevalent, particularly in companies not subject to Sarbanes-Oxley.
- Employees are not necessarily “cooking the books” for personal financial gain (i.e., compensation) but to ensure the survival or continued success of the company and to avoid termination.

Case A
- An employee made $6 million of false accounting entries simply to validate the forecast for which he was responsible and keep his job. This caused the company to violate its bank covenants.

Case B
- A company’s subsidiary was over-charging vendors for rebates to increase gross margin.
Early Detection Strategies

- Proper review and approval of accounting entries is critical, even at the highest level (e.g., CFO review of any entries made by Controller, and so on).

- Thorough review of monthly reported results vs. budget/forecast vs. prior periods by senior management.

- Thorough analysis of balance sheet accounts on a monthly basis by senior accounting/finance personnel.
Polling Question 3

Early detection techniques for financial statement fraud may include the following:

A. Review of journal entries
B. Periodic review of forecasts and budgets vs. actual results
C. Monthly balance sheet account analyses
D. Evaluation of internal controls
E. All of the above
Immediate Next Steps if a Potential Fraud is Detected
Do’s and Don’ts

**Do’s**

- Advise senior management, general counsel and external counsel.
- Best practice: external counsel engages forensic accountants. If applicable, Audit Committee engages counsel separate from corporate counsel, particularly in the case of a public company.
- Preserve data (especially electronic) / lock down electronic hardware (desktops, laptops, etc.).
- Manage communications / be discreet.
- Advise insurance company.
- Advise law enforcement if applicable (after consulting with counsel and insurance company).
- Advise auditors (**important**).
Do’s and Don’ts

Don’ts

- Investigate the matter yourself.
- Engage internal audit to lead the investigation.
- Terminate suspected perpetrator(s) before discussing with counsel.
- Conduct your own interviews without counsel and forensic investigators present.
- Retrieve electronic data from servers, networks, desktops, etc. – even with the assistance of IT group.
- Be uncooperative with regulators.
Polling Question 4

If you suspect that a potential fraud may have occurred, you should consider the following:

A. Discussing the matter with the appropriate colleagues
B. Conducting a preliminary investigation of the circumstances
C. Discuss the matter with professional counsel
D. Ask internal audit to look into it
E. Hire forensic accountants
It is now time for our Q&A session.

Click the “Q&A” button, type your question in the open area and click “Q&A button” to submit.
Thank you for attending!

Reminder to obtain CPE credit

- Individuals: No further action is required
- Proctors on behalf of a group:
  - The group proctor should be the same individual who logged in to the web and teleconference lines
  - Submit the group sign-in form within 3 days (available by clicking on the Presentation Assets section on the left side of your screen)

- 1.0 CPE credit hours will be issued to eligible participants within 60 days
- NASBA will not issue credit if all criteria is not met, without exceptions

Follow-up materials

- The presentation slides and a link to the call recording will be sent to all participants within a few days of the webinar
Appendix
10 Hallmarks of Effective Compliance Programs

- Training and Continuous Advice
- Incentives and Disciplinary Measures
- Third-Party Due Diligence and Payments
- Risk Assessment
- Tone at the Top
- Code of Conduct
- Oversight, Autonomy, Resources
- Confidential Reporting, Internal Investigation
- Continuous Improvement
- Mergers and Acquisitions
Hallmark 1

Tone at the Top

- Is there a commitment from senior management and a clearly articulated policy against corruption?

- Is senior management setting an unambiguous example?

- Does mid-level leadership set the same tone as executive leadership?

- Is your compliance framework simply a paper program, or does it serve to create and support a culture of compliance?
Hallmark 2

• Do you have a code of conduct and related compliance policies and procedures?

  Code of Conduct

• Is your code clear, concise, and accessible to all employees?
• Is your code available to employees in their local language?
Hallmark 3

- Has the company assigned responsibility for compliance to specific senior executives?

- Does your program’s owner have direct access to the organization’s board or audit committee?

- Are the resources allocated to compliance proportionate to the complexity of the organization, industry, geographic footprint, and specific business risks?
Hallmark 4

- Is your compliance program a “one-size-fits-all” approach? Such programs are generally ineffective, and perhaps even counter-productive.

- DOJ and SEC give meaningful credit to companies that implement a comprehensive risk-based compliance program in good faith

**Leading Practices:**
- Evaluate corruption risk by country
- Identify and include “red flags” as part of the risk assessment
- Incorporate FCPA controls into SOX control infrastructure
Hallmark 5

Training and Continuous Advice

• How effective is the communication of relevant policies and procedures throughout your organization?

• Is your training tailored based on level, roles and responsibilities, and types of interaction with government officials, etc.

• Is all training delivered in the local language?

**Leading Practices:**
• Consider a risk-based approach to training
• Incorporate real-world scenarios in simulation-based training
• Vary your training delivery models
Hallmark 6

- Does your company publicize disciplinary actions internally?
- Do you offer rewards for ethics and compliance leadership?
- Are you consistent in the disciplinary and incentive actions that you take?
Hallmark 7

• Do you know your vendors?
• Do you understand the business need for including third-parties in various transactions?
• Are you performing ongoing monitoring of third-party relationships?

Leading Practices:
• Incorporate anti-corruption clauses in all agent and vendor contracts and agreements
• Evaluate all agent agreements at least annually
• Perform risk-based vendor audits on a regular basis
Hallmark 8

• Does your program provide for truly anonymous hotlines?

• Do you have an efficient and reliable process for investigating allegations?
Hallmark 9

• Are you performing periodic testing and review of your compliance program?

• Can you demonstrate that your program is continually evolving to reflect changing business conditions?

• What is actually being done differently, as a result of allegations and identified weaknesses?
Do your pre-acquisition due diligence and post-acquisition integration approaches adequately consider corruption risk?

Inadequate due diligence may lead to a continuation of corrupt practices, or the “acquisition” of existing liability.

If not practical during due diligence; have you considered a thorough post-acquisition FCPA due diligence process?

**Leading Practices:**
- Ensure your anti-corruption policies and procedures are quickly applied to the newly acquired company
- Train all newly acquired personnel who present corruption risk on your policies and procedures
- Conduct an FCPA-specific audit of the newly acquired company as soon as possible
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