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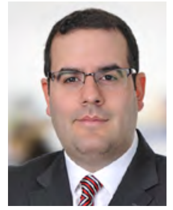

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Effective Use of Forensic Accounting in Internal Controls Investigations

By Ellen Zimiles, Claiborne (Clay) W. Porter & Alex Shea

Investigations covering complex and sophisticated corruption schemes often end up focusing on a company's internal controls to understand if and how potentially improper payments were made and whether existing internal controls were insufficient to detect and deter those payments. In recent years, internal controls investigations have taken on heightened importance in Foreign Corrupt Practices Act (FCPA) investigations where enforcers have increasingly relied on the FCPA accounting provisions or books and records charges to resolve investigations. Indeed, since 2015, almost half of all FCPA resolutions were books and records-related. Additionally, the vast majority of these internal controls cases involve efforts to hide improper payments through third-party vendors.

Internal controls or books and records investigations typically require following complicated financial transactions through a labyrinth of vendor invoices and contracts, bank accounts, supply chains, and emails, and are by nature complex and time-consuming. With the U.S. Department of Justice expecting greater and faster cooperation, and companies demanding quick, targeted investigations, forensic accountants are positioned best to help law firms, their clients, and companies more quickly and efficiently identify potential improper payments, weaknesses in internal controls, identify when internal controls have been circumvented, or give comfort that the company's internal controls were not circumvented, and assist with remediation. Using forensic accountants to follow the money also provides an independent eye and helps mute suggestions that an internal investigation was not thorough or the law firm did not look hard enough for nefarious conduct in an effort to please a client.

In other words, just like when your doctor refers you to a specialist to ensure you are getting the right diagnosis and treatment for a complicated medical issue — forensic accountants are the specialists in internal controls and can provide invaluable insight and, when the government is involved, can test the government's theory in a way that a company's advocate may not be able to when sitting across the table from the enforcers. Indeed, even the government itself uses forensic accountants to review transactions and internal controls to help build its own cases.

Though each internal control investigation is unique and requires painstaking attention to detail, there are core principles that guide these investigations. These principles are summarised below and case examples are provided to demonstrate how these core principles work in practice.

1. **Core Principles of an Internal Control Investigation**

A. Review of the Procurement to Booking Life Cycle Processes

A comprehensive forensic internal control investigation includes a review of the following five processes that form a corporation's procurement to booking life cycle. This life cycle captures the entirety of the areas that are typically exploited to cover up or hide improper payments — it represents

the beginning and end of any scheme to circumvent internal controls. The five key processes include:

(i) Procurement: Identifying and purchasing goods or services from a vendor
(ii) Vendor onboarding: Obtaining documentation and screening the vendor
(iii) Accounts payable and invoice processing: Collecting and recording vendor invoices
(iv) Treasury and payment functions: Disbursing or remitting funds to external vendors
(v) Accounting treatment: Method of recording the activity related to the vendor and the transaction in the accounting records

B. Review of the Key Components of the Life Cycle Processes

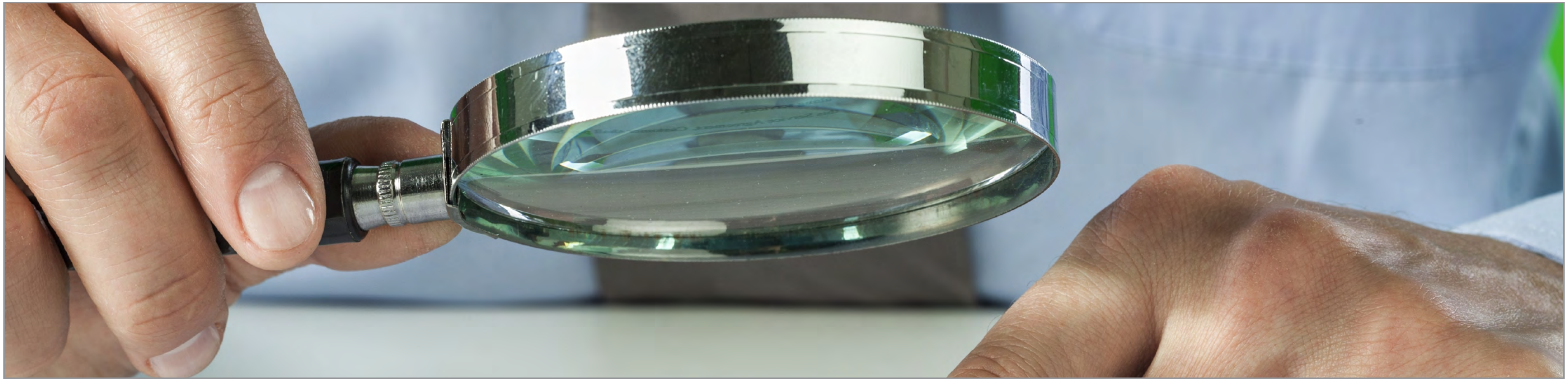
Within this life cycle, the internal controls investigation methodology should include an evaluation of how the five life cycle processes are executed by employees, compared to how those processes should be executed according to proper existing internal controls documentation, if applicable. To do so, each process in the life cycle should be thoroughly tested to uncover any indication of circumvention of internal controls, reveal weaknesses in the processes, and to better guide remediation efforts. Below are the descriptions of the three key components used in testing each life cycle process.

2. **Governance, authority, approval, escalation, and delegation**

A system of checks and balances that every contract or deal change must pass through is necessary to prevent rogue employees from hiding illegal acts.

It is also important to ensure that the checks and balances are properly enforced and tailored to a company's risk profile. Forensic accountants will then be able to quickly use these checks and balances to test whether there was a weakness in a company's governance that was exploited to make improper payments.

For example, in February 2016, the SEC announced that SAP SE, a software company, agreed to pay nearly $3.7 million to resolve FCPA violations related to internal controls deficien-



cies.[1] According to the cease-and-desist order, employees were able to create a slush fund to bribe a government official of Panama through the use of large software discounts because they knew that there was no one at the company verifying the reasons for the large discounts.

3. **Documentation**

Reviewing documentation of payments in comparison to what is required in existing internal controls may reveal methods of making and hiding improper payments such as fake invoices and bogus payment instructions. Forensic accountants are able to conduct internal controls investigations focusing on documentation with little or no audit trails through a review of, for example, vendor background information and ownership structure, and vendor invoices and payment details, as well as any changes related to the vendor agreements or departures from business-as-usual with a vendor.

For example, in January 2017, Orthofix International N.V. (Orthofix), a medical equipment manufacturer, agreed to pay the SEC approximately $6.1 million to resolve FCPA violations related to internal controls deficiencies in Brazil, including disgorgement and prejudgment interest of approximately $3.2 million and a $2.9 million civil penalty.[2] Orthofix also agreed to retain an independent compliance consultant for one year to review its FCPA compliance program. Orthofix's subsidiary, Orthofix do Brasil LTDA (Orthofix Brazil), schemed to use large discounts and to make improper payments through third-party commercial representatives and distributors to induce doctors working for government-owned hospitals to use its products. Orthofix Brazil used fake invoices for the purported services, which were booked as legitimate expenses.

4. **Segregation of Duties**

Segregating conflicts of interest and duties is a simple concept, but it is often not followed and leaves companies vulnerable to a circumvention of internal controls. Many times, foreign subsidiaries of large U.S. companies have insufficiently staffed treasury, accounting, sales, and purchasing departments, which result in conflicting duties that can provide the opportunity for an employee to hide an improper payment. Forensic accountants are trained to find weaknesses in internal controls that allow some units or persons the authority to, for example, make payments, approve payments, and change the terms of payments.

In September 2017, Alere agreed to pay the SEC approximately $13 million to settle FCPA allegations[3] related to internal control deficiencies including not properly segregated duties. However, a more notable example — though not a FCPA case — is the Volkswagen clean diesel marketing litigation, where Volkswagen agreed with the EPA that it did not properly segment its duties and, consequently, implemented subsequent remedial measures to ensure that employees involved in certification testing and monitoring are organisationally separate from product development.

Conclusion

These examples highlight the sophisticated and complex nature of a thorough internal controls investigation. A transaction review or investigation using well-designed analytics by forensic accountants can more efficiently identify a failure or breakdown among the procurement to booking life cycle processes. Not only can a company and its counsel rapidly uncover the areas used to make and hide potential illicit payments, but periodic reviews of the life cycle will also identify critical gaps in an anti-corruption compliance controls environment and can serve as the basis for remediation and compliance program improvements.

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1. SEC order instituting cease-and-desist proceedings, in the matter of SAP SE (February 1, 2016) (File No. 3-17080). https://www.sec.gov/litigation/admin/2016/34-77005.pdf.

2. SEC order instituting cease-and-desist proceedings, in the matter of Orthofix International N.V. (January 18, 2017) (File No. 3--17800). https://www.sec.gov/litigation/admin/2017/34-79828.pdf.

3. SEC order instituting cease-and-desist proceedings, in the matter of Alere Inc. (September 28, 2017) (File No. 3-18228). https://www.sec.gov/litigation/admin/2017/33-10417.pdf.