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# Triggers and Internal Controls

How to develop better processes  
for assessing and disclosing risk

Matt Kelly

Editor & CEO

Radical Compliance

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## Who is this guy again?

- Writing, blogging independently at [www.RadicalCompliance.Com](http://www.RadicalCompliance.Com)
- Previously editor at Compliance Week, 2006-2016
- Doing various research, writing projects for private clients







## Agenda

- What the law says about 'effective' internal control
- Recent interesting SEC enforcement actions
- What a good internal control process should achieve
- Management override of controls
- Q&A

# Part I. Internal Control and the Law

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## Polling question one

What is your job title?

- A. Compliance officer
- B. Internal auditor
- C. External auditor
- D. Internal control/anti-fraud specialist
- E. Other

# The Starting Point: Foreign Corrupt Practices Act

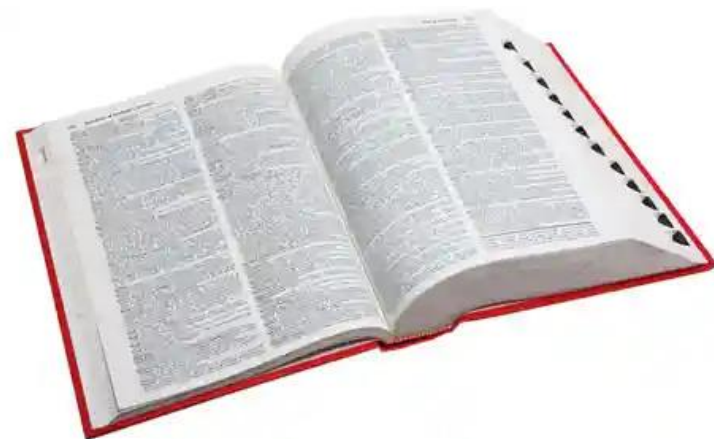
Companies must devise and maintain a system of internal accounting controls 'sufficient to provide reasonable assurances' that—

- Transactions executed according to management authorization
- Transactions are recorded properly
- Access to assets is permitted only according to management authorization
- Recorded accountability for assets is reconciled with existing assets

## The Starting Point: Foreign Corrupt Practices Act

**Q.** So what is 'reasonable assurance,' precisely?

**A.** 'Such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs.'



**From that statutory language, a thousand enforcement actions bloom.**



## Common FCPA Internal Control Violations

- Lack of evidence for discounts
- False spreadsheets vs. 'real' transactions
- Loose accounting policies
- Inability to resolve issues
- Inadequate audits (or no audits) to identify weaknesses



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*But what about everything else?*

## **Part II. Recent Non-FCPA Enforcement Examples**

## Polling question two

How frustrating is effective ICFR to achieve?

- A. Easy
- B. Fairly easy
- C. Moderate
- D. Hard

## Example 1: Sequential Brands Group

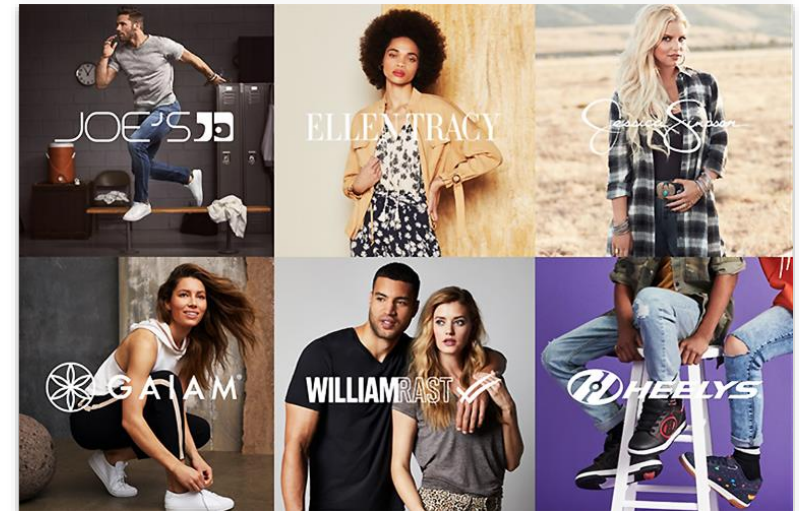
- Charged by SEC, December 2020
- Failure to disclose goodwill impairment in timely manner
- Impairment had become clear late 2016
- No disclosure to investors until late 2017
- \$304 million impairment finally coughed up





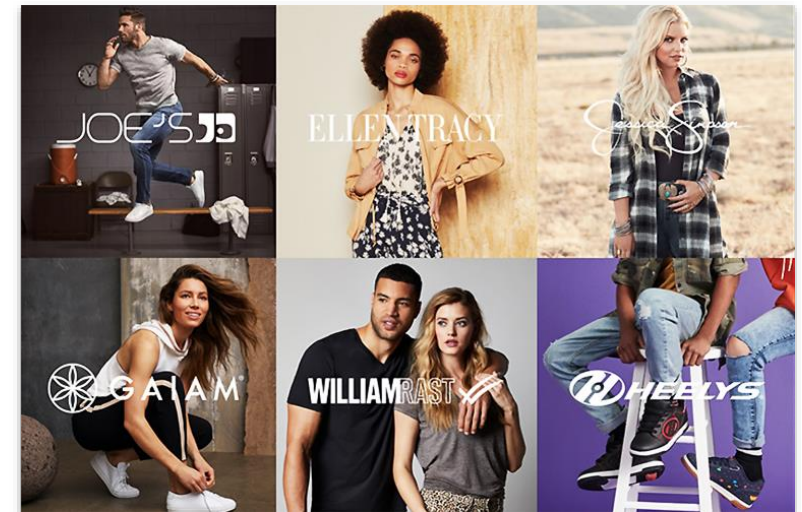
## Sequential: What actually went wrong?

- Sharp drop in share price
- By late 2016, objective analysis concluded impairment was necessary
- SEC: senior executives then performed 2nd, subjective analysis
- Which led them to keep quiet on impairment



## Sequential: The killer quote

‘In other words, although objective evidence in Sequential’s possession... showed that it more likely than not was impaired, Sequential undertook a qualitative assessment to answer the same exact question that had already been answered “YES” – **through objective, quantitative evidence** – “NO.” ’



## Example 2: Andeavor Corp.

- Formerly Tesoro Corp.; acquired by Marathon
- Charged by SEC, October 2020
- Failure to govern insider stock trades
- \$20 million fine
- Implications for 10(b)5-1 plans



## Andeavor: What actually went wrong?

- Late 2017: On-and-off acquisition talks
- Jan. 2018: Andeavor CEO resumes talks
- Two days prior, \$250m share buyback OK'ed
- Violation of company policy on material, nonpublic info (talks resuming)
- Poor internal control over compliance w/ that policy



## Andeavor: The killer quote

‘Andeavor’s informal process did not require conferring with persons reasonably likely to have potentially material information regarding significant corporate developments prior to approval of share repurchases.’





## **Part III. What Internal Control Should Achieve**

## Polling question three

Are you still listening?

- A. Yes
- B. No

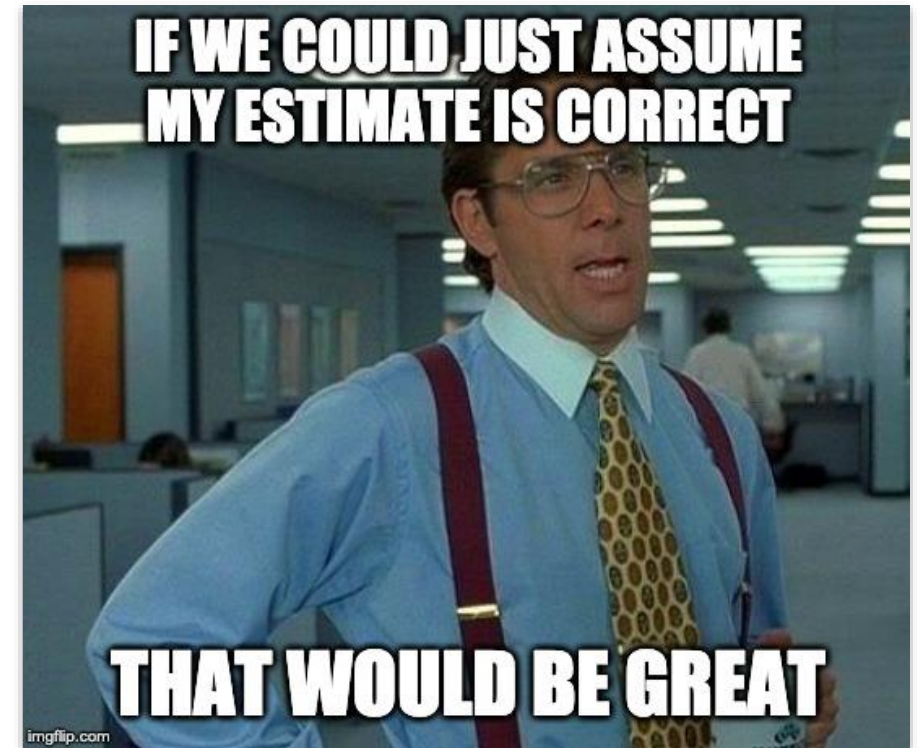
## It's About Structure, Process & Evidence

- An internal control is a **process** that generates a **result**.
- A process should have **structure**, so it can be **repeatable**.
- The **more objective evidence** you process can collect or **produce, the better**.
- The evidence **generates transparency** into the transaction, **which provides assurance**.



## A Word About Management Override

- The problem isn't management override of internal controls
- It's **inappropriate** management override
- Defeat that by internal controls that force the collection of objective evidence
- Then inappropriate override sticks out like a sore thumb





## Related Reading

- [ICFR, Still Driving Companies Nuts](#)
- [SEC Charges Retailer on Goodwill Impairment Issue](#)
- [SEC Warning on Insider Stock Sales](#)
- [Compliance 101: Defining an Internal Control](#)
- [Conn's Lessons on Management Estimates](#)
- [Oh, Gee: Fraud Case Involving Estimates](#)
- [Hertz, Estimates, and Internal Controls](#)



**Thank you!**

**Matt Kelly**

**[www.RadicalCompliance.com](http://www.RadicalCompliance.com)**

**[MKelly@radicalcompliance.com](mailto:MKelly@radicalcompliance.com)**

**@compliancememe**

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**Q&A**

**Questions?**



## Disclosure

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