



Internal Investigations

Revealing The Core Of Corruption



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An internal investigation of fraud, bribery and other types of malfeasance often is difficult to conduct and can be disruptive to business operations. When made public, an investigation also can cause an organization great reputational harm. To mitigate these risks, companies need to take a holistic approach to an internal investigation, coordinating and synchronizing multiple actions that require investigative, legal, technical and communications skills and expertise. This article — detailing a series of FTI Consulting engagements involving one company in China — illustrates some of the challenges that arise in an internal investigation and describes how they best can be addressed.



Setting the Scene

The factory was located in a poor, little-known inland province in a dusty industrial town just like hundreds of others in China and elsewhere in Asia. Over the years, row upon row of corrugated steel facilities had been thrown up on scrubland. The sun was always dim, filtering through the unremitting smog.

This factory was very profitable for its Western owners due, in part, to the efforts of its Chinese general manager (“GM”). A diminutive man in his late 40s, the GM was energetic, smart and greatly

respected by his employees. Dedicated to the business and his job, he put in long hours at the plant. His reputation within the company’s Western management was spotless. He had been GM for 10 years, and the business had thrived.

One day, the company’s senior Western management team heard a rumor, merely an employee’s passing comment, that the hotel near the facility — the only decent place to stay in town and the one in which the company’s executives reside when visiting — was owned by the GM. Contractually, the GM should have disclosed his interest in the hotel, particularly as, if true, he was deriving income from the company by owning the business. But he hadn’t.

Initially, management was disinclined to pursue the matter — why rock the boat? The GM was an excellent employee; the hotel was of a decent quality (especially for the area); the rates it charged were appropriate to the market — and side businesses were par for the course in Asia. Management knew that when someone in Asia is an influential person,

as was the GM, it’s almost inevitable that he or she will have a little something going on the side. Family, friends and local business partners invariably approach such a person with a constant stream of business opportunities. It virtually is impossible to say no to all of those offers so, eventually, side interests start to accumulate.

However, the rumor about the GM owning the local hotel reached the company’s board, which, at first, was split about whether there was cause to investigate. The board ultimately concluded that if it was true that the GM was running a business and had chosen not to disclose that information, that might be an indication of a more serious problem at the facility the GM ran. That, in the board’s view, warranted an investigation.

The company’s legal counsel reached out to FTI Consulting’s Global Risk & Investigations Practice (“GRIP”) to determine — discreetly — if the allegation that the GM owned the hotel was true. That was the beginning.



The Discreet Phase: From the Outside In

The first step GRIP took was to identify the company that owned the hotel and then to access the public State Administration for Industry & Commerce corporate records on the operation. At first, there seemed to be no connection to the GM. But when GRIP dug deeper, researching the historical records of the hotel's initial filing, it discovered that the GM had founded the business and — through another company he owned — still was the majority shareholder. The hotel's legal representative (all

companies in China are required to appoint a legal representative) had been changed just the year before from the GM to a person who subsequently turned out to be the GM's driver and close friend. These findings led GRIP to send an investigator to the hotel.

The investigator asked the hotel manager about the possibility of hosting a conference there and what it might cost. Casually chatting with the manager about arrangements, the investigator learned that the real owner and decision maker, in fact, was the company's GM.

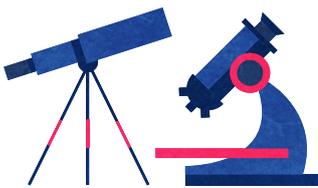
Now that the initial allegation about the GM had been confirmed, GRIP started an extensive search of public records, social media checks and further on-site inquiries, piecing together a picture of the GM's inner circle of family and friends. The thinking was that since the GM already had demonstrated a propensity to use a friend to mask business interests, additional members of the GM's circle

might be representing him in other companies and business operations. GRIP ran checks on the GM's close personal network and discovered that his mother, a retired language professor now in her 80s, was the legal representative of a recently incorporated construction company.

GRIP reported its findings to the company's Western management and was informed that the company was in the process of purchasing a large tract of land nearby upon which it intended to build a new factory. To do that, it would need to hire a construction company.

The opportunity for corruption was clear. In the natural course of business, the GM would be responsible for finding and contracting with a construction company to get the new facility built. Consequently, the company asked FTI Consulting's GRIP to continue and expand its investigation.

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The Overt Phase: From the Inside Out

The first stage of the investigation was conducted discreetly, outside the company. No employees were interviewed; no investigators entered the facility; no company records were accessed. The second stage would move inside, examining books, records and the GM's computer. Now it would be an open,

overt internal investigation, and that generates a universe of risks that must be managed.

In China, as everywhere in Asia, the personal and the professional are deeply entwined. With the explosion of social media and the proliferation of smartphones throughout all of Asia, news and gossip spread with digital speed. It should be assumed that once one person inside a company becomes aware of an investigation, everyone will know within 24 hours. Therefore, the company and FTI Consulting needed to take steps to secure evidence and manage public reaction to the investigation both inside and outside the company.

To mitigate the reputational risks to the company and manage the messaging

around the investigation, FTI Consulting called upon the skills of its Strategic Communications segment.

Working with the company's senior Western management team, Strategic Communications helped design the messaging about the investigation to internal employees, from factory floor workers on up, and external stakeholders.

The GM was a significant figure in the province; investigating him would attract the attention of the local press, which enthusiastically covers stories about corruption when foreign-owned companies are involved. The international media in Shanghai and Beijing, which keeps a keen eye on local counterparts, also likely would pick up the story immediately.

The company, possessing the fruits of FTI Consulting's investigation, now had to make a series of decisions.

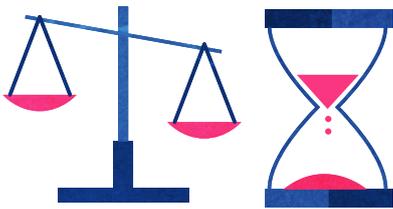
Strategic Communications needed to prepare to engage with all these outlets to make sure the company would be presented in an optimal light.

At the same time, Strategic Communications helped plan for how to handle the company's employees and managers when the story broke — to mitigate operational risk, as well as to ascertain which government agencies and officials needed to be kept informed about the investigation.

The GM's actions raised the specter of bribery and corruption, which was a potential problem far larger in scale than the hotel business and even the possibility of bid rigging for his construction firm. To see how deep these waters ran, FTI Consulting brought in its Forensic Accounting and Technology teams to thoroughly examine the company's books and records on-site, beginning with the contracts for the new facility to evaluate whether reporting requirements for both the home and the host country were being adhered to.

Meanwhile, the Technology team secured the relevant company computers and began reviewing the GM's electronic activities. The group was responsible for controlling the data as a whole to establish a reliable, valid and defensible chain of evidence.

All this research quickly began producing a large volume of data from disparate sources, which the Technology team was able to categorize and make available to legal counsel, investigators and company executives.



Truth and Consequences: Decision Time

Through the inspection of the company's books, it became clear that the GM also had been using payments channeled through third-party consultants (predominantly travel agents) to take government officials on lavish trips to Europe — bribes for the purpose of securing contracts. This no longer was a matter of an employee making a little money on the side by steering executives to his hotel; this was a bribery and corruption case that posed a significant threat to the company, exposing it to a variety of Chinese and international anti-bribery and corruption laws.

At this stage, the GRIP team undertook a series of on-site interviews with key company employees, including the GM and his next in command, which revealed the extent to which other members of senior management were involved.

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The GM had deep roots within the company and the province. If he was fired, or prosecuted, what would the reaction be among the workers, many of whom he had hired? Would they disrupt operations? How would government officials react? On the one hand, several officials appeared to have personally benefited from their association with the GM. On the other hand, the last thing senior authorities wanted was for a large taxpayer and employer in their province to get on the radar of the government's Central Committee for Discipline Inspection. That wouldn't be good for the province nor for the officials responsible for running it.

And if the GM was dismissed, who would replace him? He had personally hired his subordinate, the individual next in line for the job. To what extent was that person aware of or involved in the GM's scams? (As noted above, GRIP investigated the GM's heir apparent and found him to have had knowledge of the GM's activities but not to have been an active participant in them.)

Ultimately, the company decided its best course was to dismiss the GM and a handful of his inner circle. The employees accepted the new GM — their jobs were important to them. And the reaction of both provincial and government officialdom was minimal. Consummate realists, once the GM was out of power, they shrugged their collective shoulders and waited to see how the new GM would work out.

Nor did the now former GM make heavy weather. Fluent in languages, at ease in dealing with Western businesspeople, he became a provincial ambassador. The company did not pursue civil litigation against him.



Lessons for Companies

In Asia, allegations against managers many times come via whistleblowers posting rumors on social networks or someone (often the person in question) uploading a photograph showing an example of conspicuous consumption — a manager's new super luxury Audi or an opulent addition to his or her home. Just as frequently, though, a company's suspicions can be raised, as they were in this case, by a passing comment. Because of this, Western management needs to keep its ear to the ground. It should maintain at least a semi-regular physical presence on the factory floor, as well as in the management offices, and not distance itself from operations, no matter how well things seem to be running. If fraud and corruption exist within an operation, people will know about it, and, inevitably, they will talk about it.

When global management is watching and listening, red flags can be recognized for what they are: potential signs of fraud

and corruption. One common signal is the ongoing use of unapproved third-party contractors such as the travel agents the GM paid to arrange the trips he used to bribe government officials. If the company had examined those expenses more carefully, it would have seen that what was being delivered was not commensurate with normal business requirements. Indeed, all third-party providers should be monitored closely. If they are new to the company, they need to be thoroughly vetted (i.e., who owns the operation?), and it should be made clear why these particular parties are being used.

Companies must understand that once corruption begins to grow, its roots invariably will run deep. Certainly, if the corruption is major, senior people most likely will be participating. Those managers have hired the people beneath them, and, therefore, many aspects of the business — warehousing, sales, procurement, accounting and government relations, to name a few — likely will be involved.

This makes it almost impossible to run an effective on-site investigation with internal resources alone. It is natural for company executives, discovering they have been traduced, to become emotionally involved and immediately seek to confront the person under investigation, asking questions to which they do not know the answers. This will alert those associated with the fraud; potential evidence may go missing; and the company could find itself not knowing who or what to believe, with

little tangible proof pointing either way. It, thus, is critical for companies to get independent counsel on board as early as possible to make sure all the bases are covered and nothing has been overlooked. Once a decision is made to initiate an internal investigation, it must proceed expeditiously and with the right combination of resources.

There is nothing new about corruption. But regulatory authorities in the United States, Europe and, more recently, China — in fact, almost everywhere — are becoming more aggressive. They are better supported, funded and more capable than ever before. Companies increasingly are being taken to task and are suffering significant, material penalties for the missteps produced by lax compliance practices and simple inattention.

An internal investigation is a crisis for most companies. Ideally, with the proper compliance policies assiduously executed and maintained, such inquiries can be avoided. But once an internal investigation becomes necessary, good, professionally conducted examinations can do much more than run down malefactors and shut down their schemes: An analysis can expose the dysfunctional processes that allowed the fraud and corruption to find a purchase and, by doing so, fix them. In that way, an internal investigation, while unpleasant and unfortunate in the short term, can provide great benefits going forward — as long as the research is conducted by professionals with the time, skills and resources to do the job correctly. ■

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