

Mitigating Fraud & Corruption in China Operations

What are the best Corrective Actions? How to address on-going Risk?

Roundtable discussion with Q&A

May 28, 2024



Grant Thornton
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Webinar Agenda

Housekeeping

- Registrants encouraged to ask questions
- Click on Questions on Control Panel
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1. Review of Agenda and format

2. Introduction of Grant Thornton
3. Introduction of East West Associates
4. Mitigating Fraud & Corruption – Why is this topic so relevant?
5. Case studies
6. Q&A Session
7. Conclusion

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Dr. Tim Klatte:

- Partner, Grant Thornton, Certified Fraud Examiner (CFE), Certified Forensic Interviewer (CFI)
- Leader of the Forensic Advisory Practice in Shanghai
- Advises clients on complicated compliance investigations and effective ethics programs

Warren Clark:

- Grant Thornton - Audit Partner and Leader of National China Business Group
- Specialized in auditing U.S. based companies with operations in China, foreign private issuers, and companies going public in the U.S.
- Lived and worked in greater China for more than 18 years



Why Grant Thornton?

- Our strength lies in our strong network of regional and international offices which are supported by our devoted partners and staff.
- An easy access to international resources enables us to offer a full range of assurance, tax and advisory service to clients in every sector of the China market.



7000+
Professionals



28
Offices
Nationwide



300+
Partners



Top 5
GT International
Member Firm

*Statistics as of July 31, 2023



*Statistics as of Sept. 30, 2023



Anti-Bribery / Anti-Corruption Advisory

Comprehensive service to help businesses navigate all phases of the regulatory compliance requirements as well as respond to corruption allegations.

Event Monitoring Services

A robust service to ensure that your marketing, sponsorship or other events and 3rd party activities are conducted in full compliance with your internal policies and with the PRC and international anti-corruption legislation.

Compliance Training

Guiding employees to understand and internalize best practices in China compliance matters. We recommend or adjust existing policies to comply with global and local ABAC laws to improve the awareness of fraud across all operations of the organizations China business.

FORENSIC ADVISORY SERVICES

Fraud Investigations

Leveraging our accounting and related investigative skills, this service integrates multiple forensic disciplines to efficiently identify, collect, and analyze relevant evidence in a timely and cost-effective manner for clients.

Integrity Due Diligence

Taking an in-depth look into the public profiles and online footprint of individuals and company's to identify potential red flags prior to a clients strategic investment or partnership.

Whistleblower Advisory

Helping both local and international clients to establish, manage and support a complete whistleblowing program, which encourages staff to speak-up and report unethical activities within an organization.

Expert Witness Support

Providing expert witness support during complex litigation matters, which can facilitate an efficient dispute resolution process resulting in fewer post-decision protests.

*Statistics as of Sept. 30, 2022

Grant Thornton International (GTIL) is a leading global organization of member firms providing audit & assurance, tax and advisory services for more than 90 years. Collectively, GTIL member firms comprise*:



72,858

people and growing



704

offices and growing



135+

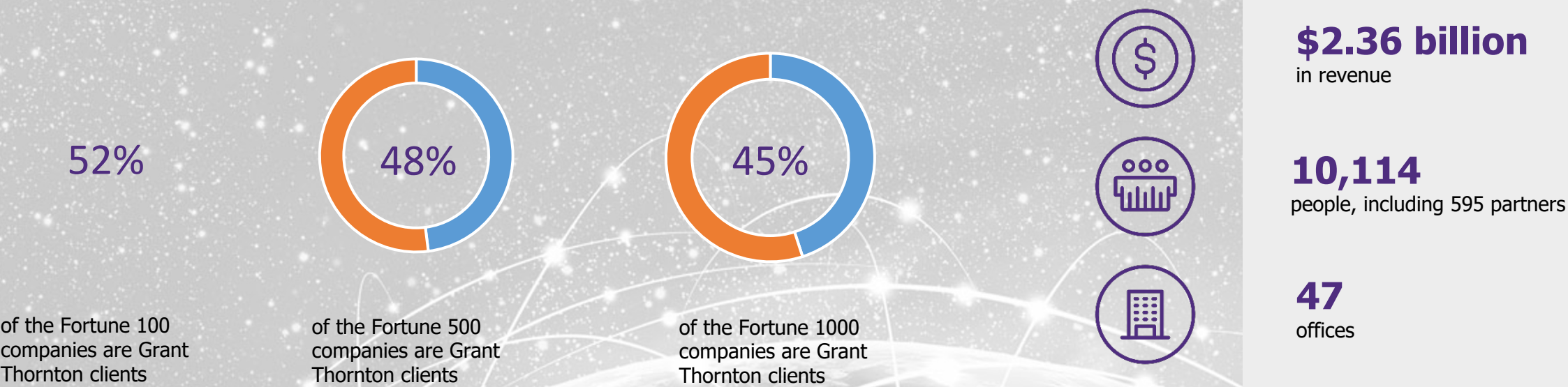
countries and growing

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Thriving since 1924, our U.S. firm is people-focused and purpose-driven. We believe business should be more personal and that the strongest results start with trust.

Who we serve*:



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EWA Executives in 5 Regions



A leading provider of Corporate Strategy, Operational, Commercial & Risk Management solutions

4 Core Services

Global Manufacturing and Supply Chain Footprint

1. Develop & implement global manufacturing footprint and supply chain strategies
2. Closure of manufacturing plants & offices
3. Consolidate & Relocate manufacturing plants & offices
4. Global Site Selection
5. Negotiate tax & business incentives with foreign governments
6. Develop set-up costs and business model
7. Factory construction, set-up, and employee hiring.

Operational & Commercial Performance

1. M&A Due Diligence - Operational, Commercial & Risk Management
2. Operational Turnaround & Restructuring
3. Process Improvement
4. Market Research

Human Resources & Risk Management

1. **Executive Search**
2. **Interim General Management:** General Manager, H/R Director, Operations Director, etc.
3. Background Checks
4. Integrity Awareness Training

Supply Chain

1. Identification & Qualification
2. Supplier Improvement
3. Supplier transition
4. Make v. Buy Analysis
5. Covert & Overt Investigations of suppliers
6. Supplier Audits
7. RFQ Pricing & Negotiations

- Founded in 2005, EWA executives have held senior management positions with P&L responsibilities for western MNCs, including

Briggs & Stratton Asia

CIATEQ Mexico

Littelfuse, Inc. China

American Standard Thailand

General Motors Automotive Poland

Eastman Kodak Asia

Bechtel Corporation China

Conceptos Para el Hogar, Mexico

General Electric Appliances Poland

Ashland, Inc. China

- EWA executives had senior management and P&L responsibilities for western MNCs in numerous key industries:

Automotive

Metal Fabrication

Chemicals

Semiconductors

Specialty Metals

Energy & Natural Gas

General Manufacturing

Consumer Goods

Packaging

Food & Beverage

Laboratory Equipment

Industrial Textile & Apparel

Durable Goods

Filtration & Separation

Electronics

Medical Devices

Food Technology

Costings & Building Materials

Dan McLeod:

- Senior Executive Advisor, East West Associates
- Former Director Asia Pacific Operations. Ashland Specialty Ingredients (Shanghai)
- Former Director of Manufacturing & Supply Chain for Hercules specialty chemicals

Li Xiao:

- East West Associates Operations Manager, China
- Former China General Manager for US construction materials manufacturer
- Former China Director hired to turnaround business and manufacturing plants for US electric motor manufacture

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Fraud Triangle

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Perceived Opportunity

- Weak internal controls
- Ineffective monitoring of controls
- Assets susceptible to fraud

Fraud Triangle

Perceived Pressure

Financial Pressure:

- Greed
- Addiction
- Poor credit rating or cash management

Work Pressure:

- Dissatisfaction with pay
- Overlooked for promotion

Rationalization

"I'll pay it back."
"I deserve a pay raise."
"It's for a good purpose."

1. Developed by Donald Cressey in the 1950s.
2. All 3 elements must be present for fraud to occur.
3. If one element is missing, then fraud cannot happen.

Grant Thornton | Understanding Fraud & "Knowing" Fraudsters

Mitigating Fraud & Corruption – Why is this topic so relevant?

Normal, prudent oversight of China operations has become more difficult in recent years

- *Years of China COVID restrictions.*
- *Recently publicized risks to business travelers to China.*
- *Unpredictable business environment there.*
- *U.S./China political tensions.*

Desire to diversify from China driven by Board of Directors, Senior Executives, Investors

Assessing your China operations and demonstrating support to your people there – in person – is important.

Not just to manage smooth and efficient operations, but also to identify and minimize instances of fraud and corruption.

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Background

1. Company is a midwestern manufacturing company with operations in China, Hong Kong and Malaysia.
2. Company manufactured electronic sensors for resale into the automotive, healthcare and industrial sectors.
3. The China operation is located in Ningbo and primarily sold their manufacturing products within China to Western and Chinese customers.
4. The Hong Kong operation was originally used as an importing entity when the company first established in Hong Kong/China in 2001. The HK operation now serves primarily as a sourcing/trading company supplying China raw materials and components to the company's other operations in Malaysia, US, Mexico and Europe.
5. The company had a formal corporate-wide whistleblower program to report an alleged wrongdoing or employee concerns.
6. Current China senior leadership had been in place for approximately 11 years with the China GM having been hired in 2013.
7. The company received several complaints to the whistleblower 'hotline' about alleged corruption at the Ningbo operations. The complaints included:
 - Kickbacks for supplies and customers
 - Fake travel invoices
 - Profit skimming

Corrective Actions

1. Grant Thornton implemented
 - Forensic accounting audit
 - eDiscovery
 - Corporate intelligence workstreams to holistically appreciate the severity of this fraudulent activity
2. As a result, Grant Thornton was able to confirm the fraud occurred, identified those employees involved in committing the fraud and the severity of the damage to the US company.
3. Company subsequently fired six employees who committed the fraud, which included the General Manager, Director of Human Resources & Chief Financial Officer.
4. Thus, the company hired East West Associates to install an Interim General Manager (GM) (Li Xiao) and Director of Human Resources. The company also engaged Grant Thornton to install an Interim CFO.
5. As a result, the company needed to (1) restore the Ningbo operation's business practices, (2) maintain stability of the business, (3) remain a viable business entity to supply customers, (4) screen and retain professional employees from leaving the company, (5) ensure the remaining China employees that the company is committed to China.
6. Secondly, the company engaged EWA to begin a formal search for a permanent GM after the company was stable, which was led by Li Xiao who was serving as the Interim GM and understood the responsibilities of the GM position. This ensured a smooth transition.

Background

PROJECT OBJECTIVES & REQUIREMENTS

The investigation aimed to uncover potential fraudulent activities by the company's local management and validate allegations made by three whistleblowers.

The allegations focused on the following areas:

1. Financial Irregularities: (1) Misallocation of government IIT refunds; (2) Unjustified compensation totaling about 1 million USD;
2. Document & Authority Misuse: (1) Receipt of fake certificates from vendors; (2) Unauthorized signing of technical service agreements by management;
3. Policy Violations: (1) Selective adherence to the T&E policy, with the management team being exempt; (2) IT unauthorized access to employees' email accounts to monitor communications on behalf of the management team.

GT PROCEDURES

1. Conducted interviews with the management team and relevant personnel to understand the internal control and policies;
2. Reviewed documents and analyzed data focusing on suspicious areas;
3. Used e-Discovery technology to review filtered files and identify actionable evidence.

GT FINDINGS

1. We substantiated 6 out of 8 allegations, for example:
 - The company misallocated the government IIT refunds;
 - Eight certificates were confirmed fake, and seven of them pointed to the same vendor;
 - The IT manager disregarded the interests of the company by taking advantage of his duty – sharing employee communications with the management team.

CORRECTIVE ACTION

1. Management team members separated from the company, and a new team was put in place;
2. A compliance committee was established, and training was enhanced and more frequent;
3. Increased communications with staff and third parties about the WB channels available if something unethical is identified.

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1. *What are the current risks to traveling to China and how is China different post-Covid?*
2. *Are there “red flags” we can look for to infer fraud or corruption in our China operations without actually going there?*
3. *What can we do now if we suspect fraud, corruption or IP theft in our China operations?*
4. *Does management and employee Fraud & Corruption Training really help?*
5. *How effective is a formal whistleblower program? Has it changed since Covid?*
6. *I’ve got a guy who’s a real rainmaker for us in China, but I’m not absolutely sure about his integrity? What should I do?*
7. *If I find a problem in China, is my degree of risk limited to within China?*
8. *If I decide to sell my China operation and move production elsewhere, how concerned about this topic do I need to be?*
9. *What are the real-life challenges when implementing a new operational strategy or conducting forensic accounting after the ‘dust has settled, and any unhealthy employees terminated?*

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