YOU SEALED THE DEAL - NOW WHAT?

CONDUCTING POST M&A THIRD PARTY DUE DILIGENCE

Live Webinar: March 16, 2017
About The Red Flag Group

The Red Flag Group is a global professional services firm specializing in integrity and compliance risk. We have completed over 500,000 due diligence reports for thousands of companies in the past 10-years and work with many Fortune 500 companies.
Agenda

- Introduction
- Overview of Pre-M&A process
- Pre-planning the DD process
- Setting the acquisition due diligence third party strategy
- Risk ranking third parties of the acquired company
- Managing third party red flags inherited through acquisition
- Benefits and practical considerations
- Questions and answers
OVERVIEW OF
PRE-M&A ACTIVITIES
Overview of the pre-M&A due diligence process

Acquire and filter list of:
- 3rd parties
- Customers
- Associated companies
- Individuals

Conduct a risk rating to determine how to allocate DD resources

Examine findings

Address red and yellow flags

Set up remediation tactics

Determine impact of findings on the business if deal is made

Review serious issues
Key accomplishments of pre-M&A due diligence process

- Set up a framework for risk assessment and rapid, comprehensive DD based on limited data
- Get technology platforms ready
- Coordinate between compliance, M&A, IT, procurement and other departments to have a holistic view of both legal and reputational risks
- Know what success looks like
- Examine what new risks are being introduced by entering a new market
- Know if this is a deal that you can commit to - based on the data that can be gathered during the pre-M&A process
PRE-PLANNING THE DUE DILIGENCE PROCESS
Your organization has closed the deal, now what?

<table>
<thead>
<tr>
<th>Get access to strategy for the new company</th>
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<tbody>
<tr>
<td>• Is this a new market for your company? Consider new risks</td>
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<tr>
<td>• Continue operations “as is” to expand</td>
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<tr>
<td>• Divest</td>
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<tr>
<td>• Consolidate supply chain/operations</td>
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<table>
<thead>
<tr>
<th>What information is available about acquired company’s compliance program (if they had one)?</th>
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<tr>
<td>Check out:</td>
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<tr>
<td>• Data gathering during pre-M&amp;A DD (clean room access)</td>
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<td>• Consult with M&amp;A counsel</td>
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<tr>
<td>• Hotline data involving third parties</td>
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<table>
<thead>
<tr>
<th>Check who is on acquisition integration team</th>
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<tbody>
<tr>
<td>• Business Development</td>
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<td>• IT</td>
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<tr>
<td>• Finance</td>
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<td>• Legal</td>
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<tr>
<td>• HR</td>
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<tr>
<td>• Operations</td>
</tr>
<tr>
<td>• Sales &amp; Marketing</td>
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**TOP BUSINESS OBJECTIVE:**

**Minimize business disruption**

- Due diligence is usually NOT top of mind
- Put critical acquired company EEs and third parties at ease
- Send questionnaires to existing third parties: business may object
- ‘Systems integration’ are usually dirty words to most in business
- Contract mapping and transition
Preliminary data collection and team build out

- Who are the third parties and where is the data about them?
  - Where is it? Disparate systems?
  - Expect challenges here
  - Where are contracts and what powers do they give your company?

- Assess and prioritize the risks beyond ABAC and sanctions
  - Which functions own these risks & how will that affect workflow?
  - How does the acquiring company’s existing third party risk profile change?

- Identify key players and obtain budget
  - If expanded risks profiles, which control functions own management of those risks?
  - Who is going to pay for this?

- Will you align at least a portion of the process with third party contract transition?
Post close third party due diligence process

1. Acquire and clean list of in-scope 3rd party data and build Process
2. Run all 3rd parties through on-line screening
3. Establish Risk Ratings (will a questionnaire be issued?) and request enhanced DD

- Risk mitigation plan
- Identify red flags

- Low Risk 3Ps: No Red Flags
- Low Risk: Red Flags? Or Medium and High Risk 3Ps

Monitor, measure and manage
QUICK POLL

What is typically the most challenging aspect of the post-acquisition due diligence process for your company?

A Locating acquired company’s third party data
B Integrating acquired company’s third party data
C Assessing third party risk profiles
D Resources/time taken to administer post-acquisition DD process
SETTING THE ACQUISITION DUE DILIGENCE THIRD PARTY STRATEGY

Clean and analyze data to build risk ID process
Establish in-scope third parties and risks to screen against

- In-scope third parties may depend on risks of concern
  - ABAC: entities/individuals interact with government
  - Data Security: entities/individuals who acquire PII and/or proprietary information
  - Can you make a call about this risk from a commodity code alone?

- Dedicate more resources to higher risk third parties

- May need an assessment first: new market may = different risks

- **Trend**: companies screening for risks beyond ABAC/Sanctions, now looking at: Human rights, environmental, competition, intellectual property, health and safety, etc.
STEP 1B

Acquire and analyze existing third party data

- Eliminate duplicates and obsolete third parties
- What available data can you use? If acquired company had DD process, evaluate and identify gaps
- Overlap with your company’s third parties? When was DD last run? Is the third party being used in the same capacity?
STEP 1C

What is the process?

- Will all in-scope third parties receive on-line screening?
  - Trend is: YES

- Issue a questionnaire to in-scope third parties?

- Who will manage the process and resolve red flags?
  - Control functions: compliance, finance/audit, legal
  - Business involvement

- Grade the third party on the level of risk they pose
  - Determine the level of review each party receives
    - High Risk
    - Medium Risk
    - Low Risk
  - Map the risk ratings to how your company currently categorizes risks
QUICK POLL

When your Company undertakes post-acquisition due diligence does it require the acquired company’s third parties to complete a due diligence questionnaire?

A  No
B  Yes
C  Company has never performed post-acquisition due diligence.
To issue a questionnaire or not ... that is the question

- **Majority of clients do NOT immediately send questionnaires to acquired third parties due to:**
  - Concerns about business disruption
  - Perceived lack of trust
  - Burdensome (resource and budget) for team
  - Requires business buy-in and participation when their focus is elsewhere

- **How do most companies handle questionnaires?**
  - Online screening, risk rate with available data to determine need for follow up such as: enhanced DD, site audit, interview or termination.

- **Questionnaires could be sent during contract renewal or in a phased approach that follows a pattern to which the acquired company’s third parties are accustomed**
STEP 2

UNDERTAKE ON-LINE THIRD PARTY SCREENING
Run third parties through on-line screening

- On-line screening can be a quick win
  - Determine which parties get
    - a screening
    - enhanced DD
    - in-depth examination, with possibility of a site visit
  - Screening can catch obvious issues such as blacklisting, past violations or affiliations with government
  - Cost effective way to catch serious ‘hits’

- What to do with ‘hits’?
  - Confirm the workflow and who makes decisions
  - Request enhanced due diligence to remove any concern
  - Weed out false positives
  - Establish risk mitigation plan
  - Be prepared to end relationships
STEP 3

RISK RANKING
THIRD PARTIES OF
THE ACQUIRED COMPANY
Ranking third parties – Bribery and corruption

Clean data AND exclude third parties who conduct less than $X in annual business with your organization

Segment by job or commodity code: Interaction with government on your organization’s behalf

Rank by country

Annual volume

Serious screening hits

High Risk

Medium Risk

Low Risk
Internal questionnaires and what to ask for: ABAC

- Business relationship (Job code: higher risk if government interaction)
- Anticipated annual volume/spend
- Countr(ies) in which business is conducted
- Business need for relationship (DOJ wants this)
- How was third party introduced to client
- How client compensates third party
External Questionnaires and what to ask for: ABAC

- Length of time in business/experience
- Known sub-tiers
- Past compliance issues: investigations, violations, sanctions
- Government connections: officers/directors, relatives
- Long-standing relationship (any past issues)
- Demonstrated compliance programme
- Refusal to certify to client’s Code
- Conflicts of interest disclosure
- Potential human rights exposure (based on country)
# Sample levels of review

<table>
<thead>
<tr>
<th>Questionnaire NOT issued: Risk rating only</th>
<th>Basic level of enhanced DD</th>
<th>High level of enhanced DD</th>
<th>Highest level of enhanced DD</th>
<th>Site visit</th>
</tr>
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<tbody>
<tr>
<td>Low risk</td>
<td></td>
<td>![Checkmark]</td>
<td>![Checkmark]</td>
<td>![Checkmark]</td>
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<tr>
<td>Medium risk</td>
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<td>![Checkmark]</td>
<td>![Checkmark]</td>
<td>![Checkmark]</td>
</tr>
<tr>
<td>High risk</td>
<td></td>
<td>![Checkmark]</td>
<td>![Checkmark]</td>
<td>![Checkmark]</td>
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<tr>
<td>Serious screening hit (to be designated by Compliance Team)</td>
<td>![Checkmark]</td>
<td>![Checkmark]</td>
<td>![Checkmark]</td>
<td>![Checkmark]</td>
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<table>
<thead>
<tr>
<th>Questionnaire issued version</th>
<th>Low risk</th>
<th>Medium risk</th>
<th>High risk</th>
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</thead>
<tbody>
<tr>
<td>Cross check third party to existing database</td>
<td>![Checkmark]</td>
<td>![Checkmark]</td>
<td>![Checkmark]</td>
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<tr>
<td>Short-form questionnaire</td>
<td>![Checkmark]</td>
<td>![Checkmark]</td>
<td>![Checkmark]</td>
</tr>
<tr>
<td>Long-form questionnaire</td>
<td>![Checkmark]</td>
<td>(only if short-form reveals red flag)</td>
<td>![Checkmark]</td>
</tr>
<tr>
<td>Enhanced due diligence (regardless of questionnaire outcome)</td>
<td>![Checkmark]</td>
<td>(if questionnaire reveals red flags)</td>
<td>![Checkmark]</td>
</tr>
<tr>
<td>Third party contact interview (via telephone)</td>
<td>![Checkmark]</td>
<td>(if questionnaire reveals red flags)</td>
<td>![Checkmark]</td>
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<tr>
<td>On-site visits</td>
<td>![Checkmark]</td>
<td>(if questionnaire reveals red flags)</td>
<td>![Checkmark]</td>
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MANAGING THIRD PARTY RED FLAGS INHERITED THROUGH ACQUISITION
Potential sources for red flags

RED FLAGS MAY BE IDENTIFIED THROUGH:

- Acquired company communications/hotline data, and pre-existing due diligence
- Discussions with business sponsors in acquired company
- Online screening (watchlist, sanctions, negative media)
- Questionnaire, if issued
- Enhanced due diligence
- External reference checks (remember Unaoil scenario)
- Interviews/site visits
STEP 5

RISK MITIGATION TACTICS
Risk mitigation tactics

- Contracts
- Training
- Compliance programme requirements
- Customer restrictions
- Employee restrictions
- Audits
- Special deal requests
- Terminations of agreement?
- Additional due diligence
- Certifications
- Payment processing
- Extra due diligence requirements
STEP 6

MONITOR, MEASURE AND MANAGE
Monitor, measure and manage

- It is not enough to run reports once and check the box
- Renewal due diligence: in US, at least every 3 years
  - For high risk third parties, more frequent
- Training within acquired company and third parties
- Transactional monitoring – a good option until systems are integrated
  - Monitor high risk transactions and variables
  - Allows acquiring company to track and audit prior to systems integration
- Check existing contracts: insert compliance clauses and audit rights
- Develop tool kits and manuals: DD may be a whole new world for a smaller company – Be patient with everyone
<table>
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<tr>
<th>The Upside When You Do It Right: When DD Works for You</th>
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<tr>
<td><strong>US SEC issued declination in connection with the agency’s investigation of a US company for alleged FCPA violations resulting from a company’s acquisition in China</strong></td>
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<tr>
<td>Due diligence was conducted in advance of acquiring a Chinese subsidiary</td>
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<tr>
<td>Integration in China after the closing, and</td>
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<tr>
<td>Voluntary disclosure, remediation and cooperation</td>
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Practical considerations

- Third party data collection – unclean and hard to find
- Getting acquired company’s prior DD data into your system
- **Possible resistance to process**: business and third parties
- **Communication and buy-in**: acquisition integration team
- Screen first for quick win, then conduct enhanced DD
- **Resourcing**: in-house or outsource?
- **Budget**: possible write off as part of acquisition?
- Plan for unanticipated red flags – what is process?
- Mapping DD renewal strategy to contract transition
The Red Flag Group, together with A. O. Smith, will jointly present a real-life case study about their experience with compliance outsourcing. The detailed discussion will look at the genesis of A. O. Smith’s project, the implementation process, and the impact it is having on their business.

Key takeaways include:
- Communicating the new initiative to the business
- Getting, starting and integrating new processes within your team
- Possible uses of compliance outsourcing
- Best practices to manage compliance resourcing issues

Register here
Integrity Due Diligence Reports
Compliance screening
Investigations
Proactive monitoring
Professional services
Compliance technology solutions
Supply-chain risk management
Compliance outsourcing
More information?

Please select all topics that you would like us to provide more information on.

- A  Due diligence reports
- B  Compliance outsourcing
- C  Compliance technology
- D  3rd party risk management
- E  Other services
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