



Presentation for PCAOB Standing Advisory Group

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About CFRA

- Since 1994, CFRA has been **the recognized leader in forensic accounting and quality of earnings research**
- **Aggressive accounting practices** can be used to mask business deterioration
- We **uncover underappreciated differences** between reported financial results and underlying economic reality

Focus on Prevention

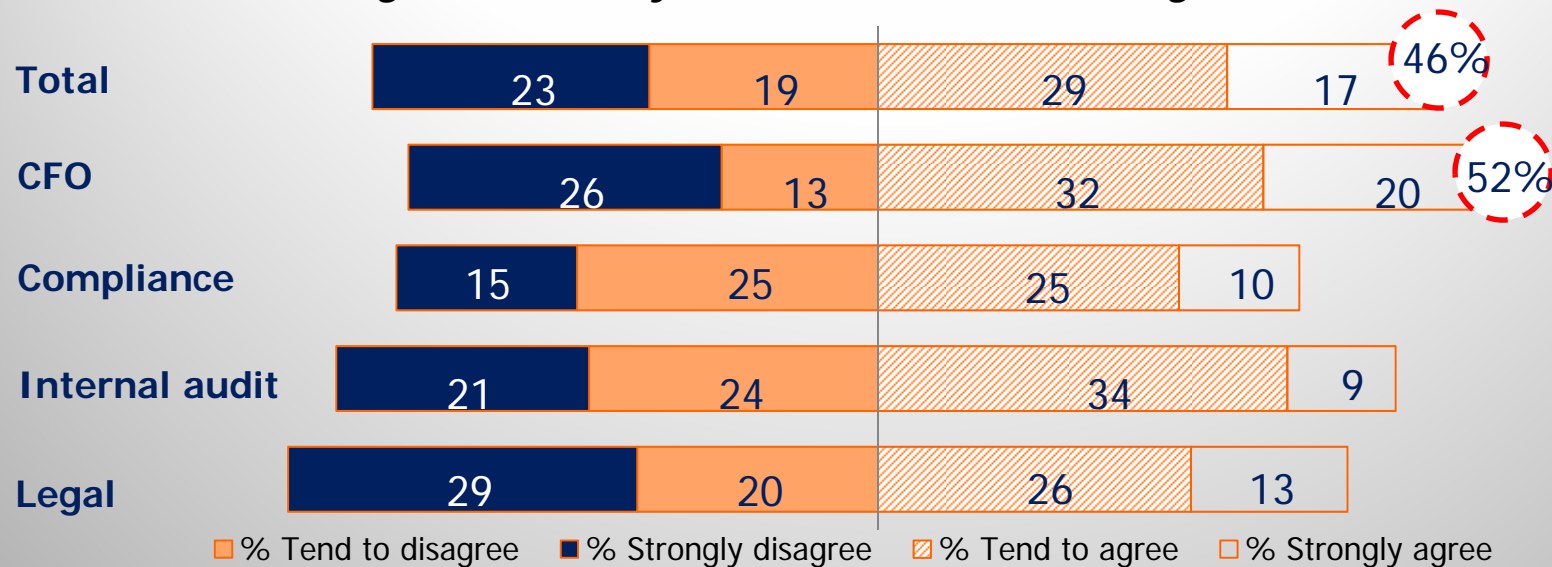
When I was the United States Attorney, I understood that when small or what some would consider relatively minor crimes are not addressed, or worse, tolerated in a community, it fosters an attitude that allows more serious crimes to occur. We have taken the same approach at the SEC. We are trying to prevent smaller securities violations from becoming more serious ones, and trying to stop individuals who are prepared to commit minor violations from moving on to bigger ones.

- Mary Jo White
Chairwoman, Securities and Exchange Commission
March 24, 2014

Focus on Prevention...“cutting corners” is common...

- Fraud starts with cutting corners, which is common
 - 52% of CFOs agreed that management cuts corners
- Sweat the small stuff – preventing aggressive accounting will prevent fraud
 - Materiality should not drive decision to question

Statement: *Management is likely to cut corners to meet targets**



Source: Ernst & Young Fraud Investigation and Dispute Services, 12th Annual Global Fraud Survey

Focus on Prevention...always be monitoring clients...

Have a dedicated group act as independent “risk manager”:

- Use quantitative tools to spot red flags
 - Accruals, working capital trends, cash flows
 - Peer analysis
 - Flagging of changes in disclosure, compensation policies
 - Executive turnover, insider selling
 - Rising short interest
- Year-round monitoring, not just annual analysis
- Monitor conference calls, press releases as well as financials
- Ask questions of audit teams
- Use third-party services with expertise

Focus on Prevention: Hiring and Staffing

- Hiring and Training are as important as tools and techniques
 - Technical acumen is important but not everything
 - Case studies during hiring process to gauge thinking of candidates? Do they ask the right questions?
 - Training should include both historical understanding of fraud and technical tools to detect
- Staffing the Audit
 - Staff should be industry experts - need to understand the industry dynamics, not just the accounting
 - Who is asking the questions around fraud?



High Level Company Considerations

- Understand the incentive structure – fraud is not only for monetary gain
 - Management Performance Factors/Incentives
 - How are lower level managers evaluated/compensated?
- Point in cycle – fraud/misstatements tend to peak at end of boom
 - Pressure on managers to keep good times going
 - Investor, regulator complacency
- Firm performance relative to peers
- High external financing needs
- M&A Activity
- Industry Risk Assessment
 - Is accounting complex?
 - What are the key valuation metrics? Growth industry or established? How have stocks fared?
 - Have there been frauds in industry? Other important news or regulation?

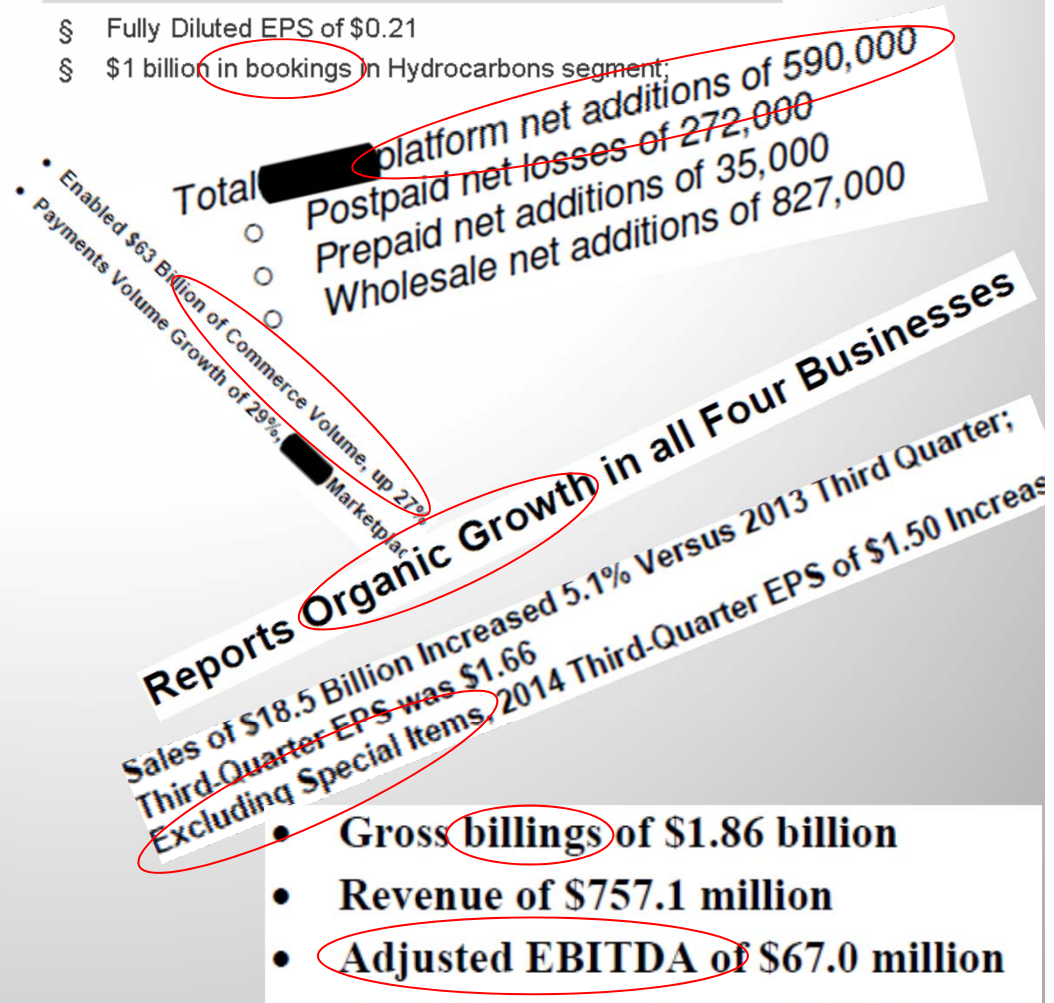
What is the Company's "Story"?

- Fraud more likely to occur in areas that drive stock performance
- Companies point investors to endless KPIs/metrics
- Focus on accounts and metrics management focuses on
 - Especially where change occurs
- Does management communication w/market match communication with audit team?
- Use third-party sources to assess investment case, both bull and bear

Announces Third Quarter 2014 Financial Results

§ Fully Diluted EPS of \$0.21

§ \$1 billion in bookings in Hydrocarbons segment;



Diving into the accounts

- Focus on
 - Revenues – policies and practices; accuracy vs. substance
 - Accounts subject to discretion - bad debts, warranties, fair value assumptions, stock comp., pensions, etc.
- Disclosure policies – any questionable omissions?
- Investigate use of Non-GAAP Metrics
 - Compare to GAAP Metrics
- Even if accounting is allowed, is it really best representation of transaction?
- Engaging the company: ask same question to multiple representatives
 - Compare responses to public comments
 - Focus on inconsistencies





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