

# GUIDE TO FRAUD DILIGENCE IN M&A.

CONTACT

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WHILE HISTORICALLY NOT AS COMMON AS LEGAL, HR, FINANCIAL, COMMERCIAL OR TAX DILIGENCE, THE RECENT SPATE OF INTEGRITY ISSUES SURFACING POST-TRANSACTION AND NEW REGULATORY INCENTIVES HAS DRIVEN INCREASED FRAUD DILIGENCE PRE-TRANSACTION.

## WHY FRAUD DILIGENCE?

RISK AVOIDANCE



Acquirers can be legally liable for behaviour committed by Targets prior to acquisition.



Integration – even if done properly – can take a year, allowing for fraudulent behaviour to fester and infect NewCo.



Reputational damage from a fraud issue can be extensive (*see case studies bottom right*).

FINANCIAL BENEFITS



Valuations can be dramatically impacted due to falsified financial and operational figures.



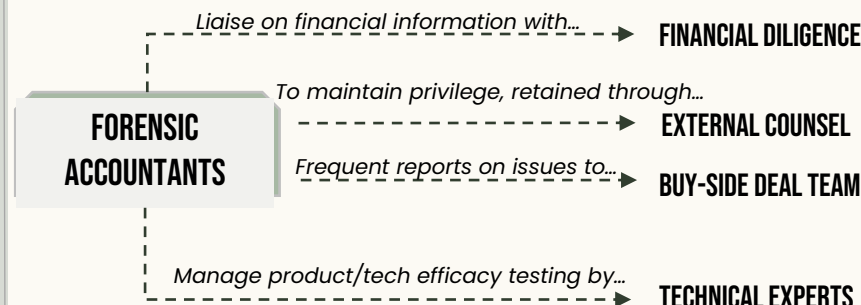
Save on the cost of remediating fraud and addressing legal matters post-transaction.



Drives the realization of synergies through identifying and remediating control, process and personnel issues.

## WHAT DOES FRAUD DILIGENCE MEAN?

- 01 Preliminary fraud risk assessment** of environment to identify key requests and design a work program.
- 02 Data analytics** on company provided information to identify red-flag transactions and data points for testing (“transaction testing”)
- 03 Testing of red flag transactions** against third-party supporting documentation and accounting guidelines.
- 04 Interviews** of key personnel on fraud risks and issues identified from transaction testing.
- 05 Technical reviews** of the efficacy of critical product and/or technologies.
- 06 Reporting** to external counsel and deal team on critical observations and recommendations in a legal-style memo.



## 3 KEYS TO EFFECTIVE FRAUD DILIGENCE

- 🔑 Get the General Ledger and Bank Statements**  
These granular documents contain the DNA of the company.
- 🔑 Audit reports and reps/warranties aren't enough**  
Audits have materiality; fraud doesn't. R&W cost \$\$/time to enforce.
- 🔑 Trust but verify**  
Trust the other side but understand they have incentive to lie.

## DID YOU KNOW?

The Department of Justice announced on October 4, 2023, that any acquirer that discovers fraud in due diligence and discloses the issue within 12 months will receive immunity from prosecution provided they remediate appropriately.

	FRANK	OZY MEDIA	SCALEFACTOR
CASE STUDIES	Acquired for \$175m in 2021. Founder sued in 2023 based on allegations that she falsified a list of 4 million customers.	CEO and other executives allegedly impersonated customers and falsified info to potential investors.	AI accounting platform raised \$100m and shut down two months later allegedly for reasons incl. AI services performed manually.

## ABOUT THE LEDGE COMPANY

**Jesse Silvertown CPA, CA, CFF** founded **The Ledge Company** after 15 years chairing various sectors in his practice at Ernst & Young, and then as the first CFO at a startup. TLC specializes in advising clients on critical financial matters including fraud due diligence.