

## ICFE Test of Reading - Sample Part 5 Task

### Questions 43 – 48

Read the following article on investigative due diligence and non-financial risk.

Choose the best sentence from the opposite page to fill each of the gaps.

For each gap **43 – 48**, mark one letter (**A – H**) on your answer sheet.

Do not use any letter more than once.

There is one extra sentence which you do not need to use.

There is an example at the beginning (**0**).

### INVESTIGATIVE DUE DILIGENCE AND NON-FINANCIAL RISK

Recent public disclosures of corporate fraud, unexpected company failure and business malpractice and corruption among well-known multinational companies highlight the need for transparency and solid understanding of the major risk from 'off balance sheet' issues. **(0)** ..... This is especially true in areas where reliable, accurate business information is often unavailable and where a heavy reliance is placed on personal relationships and consequently on personal integrity. Managers are under considerable pressure to move to emerging markets and locations where core costs can apparently be reduced. But the evidence is that, in many such cases, key decisions are made based on incomplete or poor quality information, especially as regards people and politics.

When companies are considering a possible business partner, it is important that they know and understand the risks involved and how to eliminate, or at least minimise them. **(43)** ..... Its specific goals are to unmask misrepresentation, reveal the undisclosed, clarify who you are dealing with and assess associated political and security risks.

Common problems that companies face include being overcharged for raw materials, billing discrepancies, unauthorised disposal of materials, fraudulent staff welfare claims and dummy employees, high transaction costs and other corrupt practices. **(44)** ..... The key focus must be the people and entities involved in any potential transaction or joint venture: their background, reputation, track record and litigation history must be investigated. Today there are many new entrepreneurs who have excellent qualifications, skills and connections. **(45)** .....

Investigative due diligence involves the collection, collation and analysis of information from a wide variety of sources. **(46)** ..... This research should be supplemented by in-depth and discreet investigative field enquiries. The minimum that should be achieved through this is a thorough understanding of the actual corporate structure and the background and current activities of the professional management, key officers, shareholders and subsidiaries. Additionally, it will bring to light detailed information on the character, integrity and reputation of key individuals, as well as the company's reputation with associates in the same industry and its level of political support. **(47)** ..... Other undisclosed issues, such as the use of 'sweatshop' labour or significant environmental issues that could lead to future losses or difficulties with licensing or permits, should also emerge.

Often these enquiries provide a completely different perspective from their conventional counterpart. Off balance sheet risk is manageable if companies are willing to adopt a robust approach to due diligence. Negative findings need not be a deal killer. **(48)** ..... Due diligence is particularly cost-effective when undertaken early on in the deal-making process and not as an afterthought. It will identify issues to be addressed before committing to investing considerable financial expenditure and management resources.

**Example:**

<b>0</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>	<b>F</b>	<b>G</b>	<b>H</b>
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>

- A** To do this, they cannot just rely on introductions and meetings with middlemen, there has to be a process of investigative due diligence.
- B** Such information can offer opportunities for more favourable terms to be negotiated and contracts structured to mitigate the risks identified.
- C** As a result of this, it should be possible to identify any liabilities which do not appear on the balance sheet.
- D** To avoid pitfalls such as these, it is critical that companies examine more than spreadsheets and legal documents.
- E** It fails in its aim to identify business and political risks that are not visible or obvious.
- F** However, this is not true of all of them and the lesson from many financial disasters is that it is vital to know the genuine people in business.
- G** It starts with extensive multilingual data mining of publicly available material – specialist trade publications, online resources, media, public records, and corporate filings.
- H** Such high profile cases mean that investors worldwide are discovering the danger of relying solely on audit reports and certified statements in making investment decisions.