

KLINK & CO., INC.

Your Global Risk Management Partner

Klink & Co., Inc.

Advisory to Financial Professionals

How to Thaw the Credit Freeze Global Due Diligence - The New Paradigm

Klink & Co., Inc. - Your Global Risk
Management Partner

February 2009

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Upcoming Speaking Engagements



April 26-29, 2009

Jeffrey Klink will be speaking at the
GAIM conference in the Cayman
Islands on Anti-Money Laundering.

[GAIM Ops Cayman 2009](#)

March 25, 2009

Jeffrey Klink will be speaking at the

Dear Klink & Co. Client,

How did we get here?

Thousands of fraud schemes, many of them relatively unknown, have cost investors and the global economy hundreds of billions of dollars over the past 10 years. As a result we have seen carnage in the market, including well known frauds like Stanford and Madoff, that were avoidable if investors had performed proper due diligence.

Global Due Diligence - The New Paradigm

A new global approach to due diligence, will be one way forward to instill confidence in the financial markets. New global due diligence processes will invigorate banks and investors, and mitigate fraud and operational risks.



This new way of due diligence will be based upon:

1. *Dedication to a comprehensive global analysis of patterns of success, failure, fraud, corruption, and ethical lapses.* The world is far too complex and diverse to believe that limited due diligence inquiries in one or two countries

Local Government Academy.
Details of the program to be
announced.

[Local Government Academy](#)

May 13, 2009

Dave Nolan is featured at The
Morris County SHRM. The topic,
"Preventing and Investigating
Employee Misconduct."

[The Morris County SHRM](#)

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will tell an investor enough about an opportunity to make a reasoned decision. And reliance on accounting and legal due diligence, and risk modeling and bias ratios alone have been shown to be inadequate to protect investors.

2. *Recognition that fraud is ever-present.* Investors must now recognize the importance of analyzing every detail of transactions, including the histories and activities of key principals and businesses to prevent fraud, mismanagement, and operational incompetence.

3. *Timing. Due diligence must begin long before the deal process gets to the end.* Waiting to the very end of negotiations and then having someone do a quick "background check" on the targets has been a failed due diligence model for 30 years or more.

Effective factual due diligence must replace the trust and quant-based models of failure that lead us to where we are today. Anti-fraud and corruption initiatives must be put into place. They will complement the existing due diligence roles held before by global lawyers and accountancies.

2009 Due Diligence Paradigm

Prior due diligence strategies, where fraud professionals were brought in at the final hour to bless deals, have failed. The new way forward will look, instead, something like this:

An investment opportunity will be initially reviewed by analysts and dealmakers, who may be from a hedge fund, private equity fund, bank, or other investment vehicle. Once it appears that the deal may occur, outside professionals will be brought in to protect the investors, including counsel, accountants, and risk management experts. These risk management professionals, newly introduced to the deal table, will have training in the law, accounting, finance, and computer science, and may be from law enforcement, but most importantly:

- They will have substantial experience in the identification and prevention of fraud, operational and management risk; they will see risk fraud where others won't: can develop alternative strategies; and
- They will have global resources available to identify industry, personnel, political, and operational fraud and risk issues
- The risk professionals will review available legal and accounting information during the due diligence process. But the risk professionals will recognize that valuable information must be obtained from people outside the deal.
- So, new due diligence initiatives will focus upon the

identification and analysis of information from third parties (former business partners, government sources, litigation filings, regulatory filings, media, etc.); gathering and analysis of this information that will show the success factors, risk factors, evidence of fraud, history of mismanagement, and failed deals, that are never volunteered by principals seeking money.

- This new paradigm, emerging from the shadows of the thousands upon thousands of fraud schemes and mismanagement and corruption that helped lead to the current meltdown, will require thought-provoking analysis of prior business activities on a global basis in order to protect investor capital.
- Risk professionals will search and find patterns of success and fraud, and where appropriate, argue against funding.

A look back: Timeline of the Failed 2007/08 Due Diligence Model:

Week One: Hedge fund A (replace hedge funds with bank, private equity firm, or other alternative investment vehicle) is contacted by Hedge Fund B in a major financial centre. Hedge Fund B has identified a potential opportunity involving a \$100 million funding to a business owner, who we will call Business Owner X.

Week Two: Hedge Funds A and B meet, like the idea, have multiple meetings with Business Owner X, and decide to move forward. Lawyers are retained, accountancies are retained and the ball rolls down the hill like a snowball in winter.

Business Owner X is articulate and he and his team look the part of the successful entrepreneurs.

Weeks Three Through Seven: Hedge Funds A and B spend weeks analyzing financial documents, pro formas, and likely success factors. Accountancies and lawyers draft documents and review the representations and warranties. They pore over financials.

Week Eight: Term sheets. Deal is almost finalized.

Week Nine: Hedge Fund A retains "investigative firm" to make sure that Business Owner X is safe to deal with. Investigative firm is given 1-2 weeks and a limited budget to look for any major red flags

Week 11: "Investigative firm" finds no history of criminal activity or ethical lapses and deals goes forward

Week 14: Business Owner X begins to embezzle funds.

Week 21: Hedge Funds A and B discover that Business

Owner X has taken \$25 million from the business.

Week 17: Panic

Week 28: Business is put into insolvency.

Why did this business fail? Because the due diligence efforts were poor. It turned out the Business Owner X and his team had defrauded a bank out of \$90 million before, but no one did a global search for information. Law firms and accountancies didn't find fraud not because they aren't competent professionals, but because their roles are to evaluate legal and accounting issues, not fraud, or even historical incompetence.

CONCLUSION

If investment professionals wish to thaw out the frozen credit markets, they must embrace a new paradigm of global due diligence, and one which will provide comfort to alienated investors. To change the failed ways of the past, risk professionals must be given a seat at the deal table, along with other critical members of the due diligence team. These risk professionals must be given the time and resources to identify and mitigate risk for investors and their voices must be heard.

Jeffrey M. Klink is the Founder and CEO of Klink & Co., Inc. and has saved clients over one billion dollars by doing the proper due diligence. *Some say he is obsessed with the importance of due diligence.* He can be reached at 1-800-836-8916 or 1-412-201-9123.

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