

THE MIKE ALKIN SHOW

TALKING STOCKS OVER A BEER



Announcer: Free and clear of the chatter from Wall Street, you're listening to Talking Stocks Over Beer. Hosted by hedge fund veteran and newsletter writer, Mike Alkin, who helps ordinary investors level the playing field against the pros by bringing you market insights and interviews with corporate executives and institutional investors. Mike sifts through all the noise of mainstream financial media and Wall Street to help you focus on what really matters in the markets. Now, here is your host Mike Alkin.

Mike Alkin: Welcome to the podcast. On the last podcast we had Angus Reid who's a 13 year CSL vet and wrote a really good book that I commented on and we talked about a lot called Thank You Coach. And we talked about the parallels that can be drawn from what he learned in his long, expansive career into both leadership and investing. And I thought we'd continue on that theme rather than talking about specific sectors or bringing on a portfolio manager.

Mike Alkin: I thought we would talk more in depth about what to look for. Because I was trying to draw the parallels on the last podcast with Angus about what you can learn when you're analyzing a company and you're questioning a management team and what you're looking for. And I thought it would be great to get somebody's perspective who actually worked at a big company, who saw how the sausage is made, who has various industry experience across distribution, retail manufacturing, consumer package goods, commodities. Somebody with an accounting degree. Somebody who's a fraud examiner, understands IT, understands trading books. Is a trained accountant, a CPA. I thought that would be great to get an insight as to what goes on within a company.

Mike Alkin: So sometimes what we always hear and see, you have no idea what's going on behind the scenes. And it's going to stay that way for the most part but there are ways to learn and things to know what to look for. So, we're going to spend a little time trying to get up to speed on that.

Mike Alkin: We're going to bring in Brent Brickman who is somebody I have gotten to know over the last year or so who is a trained accountant, who is a CPA from Canada. And he worked in external audit and he was controller of a small construction company, and then, he

spent 10 years in global commodities businesses, big ones, auditing various trading books around the world. He spent 15 years as a chief audit executive working in distribution retail manufacturing, CPG or consumer packaged goods. And along the way, he earned different certifications in internal audit. Risk management and fraud examination, IT.

Mike Alkin: And he recently retired, he's a great guy. And he recently retired. He's supporting his wife's medical career to care for his two elementary school age children and focus on his lifelong passion for markets, investment, and trading. And as I've gotten to know Brent, I've been incredibly impressed with his knowledge with the way he looks at companies, with the way he thinks about investing. Really, really, really savvy guy. And I thought it would be great to get him on and share some of his views. So, we will get Brent on.

Mike Alkin: Brent, welcome to the podcast.

Brent Brickman: Thanks. Thanks for having me on.

Mike Alkin: So, it's only five below where you are in Minnesota which I mean, I guess a guy who's born and raised in Winnipeg, that's kind of like spring.

Brent Brickman: Yeah. It's unusual. I'm one of the folks here that kind of looks at weather like this and I think okay, this is what I'm used to when I was growing up but it's ... I'm an anomaly here. Let's just say that. One of the only guys in Minnesota that thinks it's actually not too bad.

Mike Alkin: Well, I mean, in New York we're lightweights when it comes to cold. We think 20 is chilly so yeah, you guys get the brave heart award for that.

Mike Alkin: So, I was talking to the listeners before you came on and I was saying that the last podcast I did, I had a friend of mine on, Angus Reid. And Angus is a former NFL or CFL player with 13 year career. He won a couple of great cups. Played with BC for many, many years. And he wrote a book called Thank You Coach. And in that book, I talked about the parallels that can be drawn about what his coach, Dan Dorazio taught him about football and preparation and the will and so many things that you learn. Checklists and how to stay calm under pressure and you name it. And those translate into investing, into leadership.

Mike Alkin: And one of the things I talked about is management. We talked about management teams. And we talked about Dan's style and what you can take from that. And that segued into how over my career I've interviewed thousands of management teams for investment purposes. And you learn a lot what's going on but you're on the other side of the curtain. You're not privy to what exactly is going on to see really how things are being done. And I talked about with management how our numbers made from the top down or they come from the field up and how do things work like that. And I'd like to think that I have a decent radar for when you can sniff out BS but it's not always easy.

Mike Alkin: And so, I thought with your background from internal audit, internal controls with risk management, fraud examining, you've seen it all. And I thought it would be great for us to talk about life inside a corporation and how and what investors know, what they don't know, what they could be thinking about and looking for. So, why don't you just ... really your core of what you did was you were an internal auditor. So, for listeners who don't know what that is, why don't you explain what that role is and what you did and why it matters?

Brent Brickman: Sure. Internal auditing, if you look at what the definition of it, internal control, basically, it's all the things that people do to achieve a company's objectives or an organization's objectives. And that translates to so many different things. So, kind of what you were saying is being on the outside looking in, when you're in ... and I've done that. I did some external audit work when I was younger. But when you're on the inside, you do get a different perspective. You're part of the management team but you're also sort of at arm's length a little bit. And you can see that with how most internal auditors, a lot of them are going to have a finance background, much like mine. They have a dual reporting line, generally.

Brent Brickman: So, what I mean by that is typically you would see someone who's the chief bond executive. So, that's just professional lingo for whoever is the top internal auditor, they're going to report in a couple of different directions. So, they're going to report often administratively to an audit committee, so the audit committee of the board. And then, they're going to report functionally to management. And it's usually a C-Suite position. It's usually a CFO but it could be CEO. It could be general counsel. And this function is really part of a monitoring mechanism within a company. So you do kind of what you did asking management a lot of questions. Me and my team, we'd do the same thing but we'd do it from an

internal perspective and as you can imagine, you get very good at asking a lot of open ended questions and doing the Columbo routine like oh, just one more thing and all that, that kind of deal. And you really do gain a different perspective on a company from the inside like that.

Brent Brickman: So, it is difficult, I think, for people on the outside to really understand how messy companies can be internally and the personal dynamics that go on and so on.

Mike Alkin: How does it work? You say you report into the C-Suite. So, when you're thinking about internal controls and you're trying to make sure that the systems in place from an accounting standpoint, technology standpoint, are not deceiving people. And when it's at the C-Suite level, the CFO or the controller, if fraud is being perpetrated, it could be coming from those areas. Is that a frictional relationship or cooperation or how does that work?

Brent Brickman: I'd say usually, almost always, your objectives are aligned with the CFO. The CFOs out there, as much as we've heard about various types of corporate malfeasance, they have no vested interest have the numbers be anything but correct. So, the objectives really are aligned. But how you go about it is it's kind of a varied approach because as you can imagine, you've got information systems that are really part and parcel putting numbers together. So, you have to have integrity in that system. You will have probably more of a tug-of-war, if there is one, between business unit management and their finance support because they, of course, want to show good results and accounting and finance types have to make sure that the results reflect fairly what's going on.

Brent Brickman: So, you would have a combination of breaking a business down, looking at it from a risk assessment perspective, and is this unit big enough to cause a material issue? Do we have management that may not be that experienced? Do we have changes there that we should be aware of that might have an impact? So, you would look at things like systems. You would look at ... You'd do some standard test work to make sure that the balances match up to something or can be verified in some way. You really break it down that way. Asking a lot of questions and, of course, really diving pretty deep in how the systems actually work.

Mike Alkin: You know, I think back over the years to different companies ... I won't name names ... but some of the things from a short seller's perspective you look for are channel stuffing or when did the transfer ... when did the risk of title transfer? Did you book sales

prematurely? I could go on and on about the countless number of financial shenanigans that could occur. As an internal auditor, because there's internal and external, are you looking for financial shenanigans or are you looking to make sure the systems are in place that should detect that? And where does management judgment come into play? Or where does it come from if it's not a C-Suite executive but a divisional person? Somebody that's under pressure to perform that can play with the numbers even though the systems are in place. Are you, as an internal auditor, looking for that type of ... and I won't call that financial engineering. I'll call that financial manipulation. And is there a gray line between financial engineering and financial manipulation?

Brent Brickman: Sure. So, you're kind of looking for, at a high level, you're looking for how people, how the organization, is structured. So, if you had a business unit, for example, where the ... say it's a European operations and you've got a finance person out there that's reporting into a managing director, you're going to look at that relationship and think about how much influence that person could place on that finance professional. If you saw that relationship but you saw that finance person also being matrixed in strongly to say the CFO or some sort of central controllership function, then you would think well maybe this person, they're not going to be facing undo pressure while the business may be under pressure to perform, as they all typically are.

Brent Brickman: So you'd be looking at things from that perspective but then also diving down into the systems that will generate the figures. Where can people really influence those numbers? So, typically in a transaction processing type of process, you're going to be looking for is there adequate segregation in the function? Could one person really go and fudge the whole thing? And then, when you're getting a little higher level, you're going to be looking at where does management really make some judgements in term of things that have to be estimated and so on.

Brent Brickman: So, you're going to find that in most companies, most systems, it's going to be harder to manipulate the core processes. But to your point, you may want to go book sales more aggressively, channel stuff, that kind of thing. But you also are going to have people in systems that will not really support that activity and celebration of revenue and so on. And so, it will tend to be management's ability to influence higher level entries.

Mike Alkin: I think back to, as I think back to some of the bigger names throughout the '90s and 2000s where you saw accounting

shenanigans take place. And I think back to WorldCom for example.

Brent Brickman: Right.

Mike Alkin: And they had entered into many long-term network access arrangements. And they were leasing line costs from other telecom carriers. And these were really these costs were fees that WorldCom paid for the right to use other company's networks. And the way they accounted for those was as an expense on the income statement which it should have been. And then when it started to see tech meltdown in, I guess, 2000 it was, revenue for them began to slow and then, all of a sudden investors, now they care about expenses and they start paying attention to these really large operating expenses. And line costs, those big expenses, were the biggest single operating expense.

Mike Alkin: So, for them, if you look back at history, they were concerned about how are we going to meet Wall Street expectations with slowing revenue, and we have this big chunk of money that we owe every quarter? So, in mid-2000, late 2000, all of a sudden, you saw an accounting change. And then, rather than recording all of those costs as expenses, they started to capitalize big chunks of those as assets on the balance sheet. I mean, billions of dollars.

Brent Brickman: Right.

Mike Alkin: And so, they weren't putting it through the P&L. They were understating expenses and overstating profits for a couple of years. Is that the type of stuff internal audit picks up?

Brent Brickman: Well, internal audit will certainly pick up on that. External auditors will be looking for that too because if you think about it, if you really spend a lot of time focusing on the balance sheet, and this is where I've had people in the past tell me, well, I don't really care about my balance sheet. I only care about my P&L. Well, the two are kind of connected. Right?

Mike Alkin: Exactly, absolutely. Yep.

Brent Brickman: So, if you had a situation where items like in WorldCom, where items were being capitalized improperly, auditors will often focus on the balance sheet because if you can verify and validate the balance sheet, you know everything's been flushed out to the P&L that should be there. Now, you may have a geography issues with is it on the right line but at least it's there.

Mike Alkin: Yep.

Brent Brickman: So, you will see a focus on that. And then, within the balance sheet, you may see people saying well, while you're looking for things to be correctly stated with a bias with people who would want to show better results than they are otherwise, you look for overstatement of assets, understatement of liabilities. So, you're kind of looking at things. You're looking at them to be correct but you are looking at them with a directional bias too. And sometimes, you can get these real telltale signs where if inventory is at a level where the warehouse can't actually hold that much, that should tell you something.

Mike Alkin: Yeah, yeah.

Brent Brickman: There are situations like that that can come up.

Mike Alkin: And to what degree ... I mean, there are some things you're not going to pick up. I mean, for instance, one of the things, as you think from a short seller's perspective, or even if you're a long just trying to look at income statement, balance sheet, cashflow statements, some of the stuff that you see. Shifting current expenses to a later period is one that you've seen earnings manipulation. Sometimes, they'll shift current income to a later period to hold it back because they might have a little too much for a certain period. They could shift financing cashflows to the operating section. Right?

Brent Brickman: Right.

Mike Alkin: You can inflate acquisitions. You can inflate disposals of businesses. You can ... there's all sorts of stuff that you can manipulate that can show misleading metrics. To what extent are you interacting with the external auditors in the normal course of business?

Brent Brickman: Well, you know, that's increased over the years. So, if we just rewind a little bit, I think it's helpful to know how things became the way that they are.

Mike Alkin: Yeah, great.

Brent Brickman: So, when you think about this history lesson. If you go back to '87, there was the crash, and then, all of a sudden, we get circuit breakers that get put into the market. Shortly after that, various countries started looking at control models. And trying to

understand internal control. And it's usually after these types of episodes.

Mike Alkin: Yeah.

Brent Brickman: Right? If you get all the way up to the dot com bust. After that, you had Sarbanes-Oxley.

Mike Alkin: Yep.

Brent Brickman: Which really came down to management making an assertion over the correctness, if you will, of their financial statements and also the system of control that they have in place to produce those financials. So, as you go back through history, I wouldn't say the level of coordination between external audit and internal audit really ramped up over the last 20 years especially after Sarbanes-Oxley.

Mike Alkin: Mm-hmm (affirmative).

Brent Brickman: Because if you think about it, you are aligned in making sure that the company's financials are correct or are reasonably stated. But the process to go through to get there became much more rigorous and did require and does require a lot more coordination to get to a successful 10-K filing in the US.

Mike Alkin: So, let's talk about SEC reporting. And one of the things, on Twitter, on Footnotes First, I like to read the footnotes. Right? That's where a lot of the good stuff and juicy stuff is buried. And it's not always laid out so clearly but if it's a responsible management team that doesn't want to end up behind bars, they are typically going to put the risks in there. So, how does that work? How does the risk factor section? What role does internal audit play in that? And is there give and take with the management teams? And who decides? Does the audit committee decide how that works or how does that work?

Brent Brickman: It's really management's report so they're going to be producing ... as you know, there's a risk factor section in there. And I'll tell you, if you read any company's risk factor section, I don't know ...

Mike Alkin: You wouldn't invest.

Brent Brickman: No, you wouldn't invest in anything, right?

Mike Alkin: Yep, yep. Especially a prospectus, an IPO prospectus. Yeah, yep.

- Brent Brickman:** Right? Yeah, exactly. So, but again, if you go back to after the dot come bust especially, companies really ... They started management teams and all stakeholders really started to try to figure out how could we have these problems? Companies really need to spend more time on what's known as enterprise risk management. So, to get that linked up to risk factors, if you've got an enterprise risk management program, and most companies do. They want to look at what risks they're facing and also what opportunities they may have in there. It's a healthy exercise. And I think most companies go through this where they take a look at their risk factors and number one, do we have alignment to our understanding of our business presented in those risk factors?
- Brent Brickman:** But the thing that an investor is not really going to get out of that, I think, is how management views those risks on a relative basis. Which ones really are more likely and would have a more significant impact if that occurred? So, I think risk factors are ... You will see there's quite a laundry list in there. So, investors, I think, really would do well to ... They start to get to know management times. They listen to the calls. They look at the risk factors and really start to sense well, what's truly a risk for this business?
- Mike Alkin:** Absolutely. That's such a great point. Because there are some risks that I look at and I'm like well, that's every company and you just start going through the list. And you really want to identify what risks are relevant to this company. And it's amazing to me though how often when a company blows up, it was there. They told you it was there and you'll read a sell side report or you'll see people talking about it and they never even brought it up.
- Brent Brickman:** And it's in their interest for it to be there. And even if you link that to ... a lot of people probably listening to this podcast are resource investors. And if you look at management teams, when they're off doing those presentations and the slide they tend to skip over is that forward looking statement slide. Right?
- Mike Alkin:** Yep.
- Brent Brickman:** That's basically the slide that tells you that everything they're about to say may not happen.
- Mike Alkin:** Absolutely. And if it does, it's not their fault, right?
- Brent Brickman:** Right. So, there's also that too in addition to risk factors. These are companies that run by people and they get messy and things can

happen that you're not expecting. So, it really is in their interest to have all those things laid out in the risk factors. But I would say for most people, it would be hard to sort out without really spending some time understanding the company, which ones would make sense.

Mike Alkin: You know, it's funny that you just said these are companies run by people and things happen. And one of the things I've always chuckles about over the years is you'll look at Company XYZ, make it up. And people will say well, they've hit their quarterly number for 28 consecutive quarters and these guys are just a home run ... and I'm making up numbers here ... but they are just reliable. I look at that and say it's impossible to hit quarter after quarter to the penny when you have multi-national companies where shit happens every day. Every minute of every day. And they come into the T. So, you just assume there's some level of financial engineering taking place where there are reserves or there's something that they have because it's too hard. Things happen. Right? Think about running your house. Every day there's something.

Brent Brickman: Right. And we won't name names but you can probably imagine a couple of companies in the past. More so, 20 or 25 years ago where they're just hitting every quarter and it's like clockwork and you're kind of going that's just not how life is.

Mike Alkin: That's right. Yep.

Brent Brickman: So, it kind of gets to ... and this is what I'm saying with risk management that people will tend to look at that as a good thing. I would look at something like that as a red flag. That's just not reflecting what reality is likely to be so if you think about ... I don't know how many statisticians might be listening to this. But if you think about normal distribution curves and think about a popular improvement exercise that companies would go through, particularly in manufacturing, would be Lean Six Sigma and that gets you into standard deviation analysis. And if you think about a normal distribution curve, well, once you get out one standard deviation, so you've got two thirds of the population. If you take another standard deviation, you get all the ... Two standard deviations, say you're up to 95%. Maybe at three, you're up to 99% something. So, you've got most of the population in there. And the tails are very, very thin for four to six sigma events.

Brent Brickman: If you look at S&P returns say over the last 80 years, it isn't a normal distribution curve. The tails are actually pretty fat. The

peak of the distribution is going to be a little higher. So, people get fooled into thinking that events that are not very likely to ... They think they're less likely to occur than they actually are.

Mike Alkin: So, black swans aren't always so black then?

Brent Brickman: Exactly. Exactly. And once you start analyzing some black swans, you start realizing there actually were some signals.

Mike Alkin: Yeah.

Brent Brickman: It's very difficult for most people to ... for various reasons, and it, again, comes back to people being people ... they get stuck with cognitive biases, heuristics, different things that fool them into thinking that something that is actually occurring isn't. So, it's pretty fascinating once you start peeling it back. But getting back to the point about being able to chunk up your earnings and having them work like clockwork, I think those days are mostly behind us, unless you've got a management team that truly is up to no good. And those are pretty few and far between, I think.

Mike Alkin: I can think of one but ...

Brent Brickman: Yeah, there may be one out there.

Mike Alkin: But I'll let that go.

Brent Brickman: Yeah.

Mike Alkin: Let's talk, when we were talking and you and I were kicking around what we were going to talk about here, you mentioned fraud. And possession is nine tenths of the law. And you talked about the fraud triangle: motive, opportunity, and rationalization. And talk about how as an internal auditor, you are ... are you wired to look for fraud? Is it something that you assume all these checks and balances are in place that it's not going to happen or how do you work through that?

Mike Alkin: Because you mentioned the Columbo, right? Are you going in there thinking every day something fraudulent is happening here, let me see if I can find it? Or is it more let me make sure the checks and balances are in place that this doesn't happen?

Brent Brickman: I think what you're doing more so is just recognizing that people are people and they're going to have various types of motivations and they'll be financial because they want to get their bonus and

so, they want to make sure that the business unit is performing well. So, you're going to go in with a recognition that people are going to have certain motivations. And if taken too far, you end up with fraudulent activity.

Brent Brickman: I came across this pretty early on in my career. As you're trained as an accountant, they talk about fraud and error, fraud and error. And they say you know, you're probably never going to see fraud. It's always error. Well, I think one of the first jobs I was on, fraud.

Mike Alkin: Tell us about that.

Brent Brickman: Well, it was interesting. It was an consultancy job and I was an external auditor and called in to help on this job. And told by my boss to go through that office and see what you can find. So, I'm sniffing around and I found a corporate seal. So, this would be the thing that you would emboss paper with when you're signing an agreement. And so, I found this seal and I got a blank piece of paper and I'm like what company is that? Found an agreement. Well, it turns out that the fellow that was running this business had faked a contract with a supplier and used it for securing financing from the bank.

Brent Brickman: So, I went down and went to the bank. It was really my first experience doing this sort of thing. I sat down with the bank manager and literally saw the blood drain from his place when we presented him with these facts. The poor guy. So, these are the types of things that happen when you go in and then you're in a position where you really have to lock down the assets. You don't know who owns what. It was a security interest so the first thing you do is really lock the thing down. So, that's where I get down to businesses get messy especially in those circumstances.

Brent Brickman: Possession is nine tenths of the law, so you really are trying to lock down equipment. On one job, it was an implements dealer that had gone under and we were out at ... there were two locations. And to kind of highlight that point, the boss was off at the bank. I was at one location and a colleague of mine was at another. And he called me up frantically, this colleague of mine. And he said there's some guys here and they're going to take this piece of equipment and they're leaving with it. They say it's theirs. I said okay, well, the boss isn't here but I would tell you to do this. Tell those guys we don't know who owns what. And if they leave with that piece of equipment, you'll consider it stolen and you'll report it to the police as stolen property.

- Mike Alkin: Right, right.
- Brent Brickman: So, that's of course, we were younger guys and these guys said we're going to take it anyway. So, they get down the highway. They were stopped by the police down the highway and told to remove it, detach it, from their truck. They said no so they were all thrown into jail.
- Mike Alkin: Oh gosh.
- Brent Brickman: So, it does. Those situations get messy but they're not the norm. It's when things are going off the rails.
- Brent Brickman: Go ahead.
- Mike Alkin: I'm sorry. Go ahead.
- Brent Brickman: You are looking for things that could happen like that but you're going to assume good intent. There's all kinds of reasons why things could look a little messed up before you're getting to fraud.
- Mike Alkin: So, if I look at your career, you were in distribution retail manufacturing consumer goods. Does the job of internal auditor, is it more difficult or less difficult depending on industry? Are there certain safeguards that need to be put in place in one industry and not the other? Or is it homogenous?
- Brent Brickman: It's actually a skillset that's fairly transferrable between different types of businesses. But the risks will change and the way that you go after what you think you need to look at will change. The spread of the business, if you will, will be another thing that will be maybe the more of a determining factor. Is it a global operation or is it a domestic operation? And so, the farther that you get away from the head office and core systems, may lead you to think that you've got more risk in some of those outlying operations.
- Mike Alkin: In these global organizations, which I know you were part of one, are they ... is it all centrally coordinated or are they independent? And how does everything get coordinated from a risk standpoint? Because in the press, you do see a rogue business unit somewhere far off that went rogue. How does that typically work?
- Brent Brickman: Yeah. I'm going to give you an it depends kind of answer but it's oftentimes related to how the systems are set up, the information systems. The more coordinated or unified those systems are, then the less you may be concerned about rogue operations because you're going to have more uniformity in how you are controlling

those organizations. But the business environment would also be something that you would factor into that too. So, I'm sure you've seen that in different countries would have different, call it, corruption index scores.

Mike Alkin: Yep, absolutely. That's what I was going to go there, yep. Is that part of internal audit? The Foreign Corrupt Protection Practices Act and all that to make sure things like that aren't taking place in those countries where it's more common?

Brent Brickman: Yeah. So, Foreign Corrupt Practices Act, or FCPA, that's something that internal auditors will work on always with legal because there are certainly pretty significant potential illegal implications. And things happen in companies, but I would say that when it gets to enforcement of that act, people are really looking for well-designed systems to try to prevent that. So, what you're doing to set the tone, how you're training people so that they don't fall into that trap. And I guess for people that don't know what FCPA is, it really is where you've got ... It's illegal. It's a criminal activity to go pay off a government official.

Brent Brickman: So, any time you're looking at relationships with government or government as a customer or I mean, it could be the tax people or the fire marshal or there's a long list of potential people that you would want to keep an eye on what that interaction is like. So, internal auditors get involved in that but it's definitely an area that you would have your internal and potentially external counsel involved with too.

Mike Alkin: Is it more common than we know?

Brent Brickman: I would say that it's ... I think if you look at the global competitive landscape, I think you would say there's enough of it out there to be concerned about it and there are some high profile examples of various companies that they basically have a monitor in the business now because of past activities. But I would generally say that for most developing economies, there's enough awareness now and certainly that the penalties are pretty stiff, that I'd say there's less of it now than there was 10 or 20 or 30 years ago.

Mike Alkin: You said something about information technology and just through life, I have friends in the software industry who sell into companies. And some of the things I hear about some companies that you might just think about it, what a calamity their technology is. And we think everything is ... we see these big companies out there selling software and you think every company

has it all together and I always laugh when you see big mergers of companies and these big cost savings programs.

Mike Alkin: Over the years, you look, and the IT programs are just a calamity when they're trying merge ERP systems, right? But even down to the individual level of what programs they're running and yet, you've got disparate systems all over the place which ultimately can lead to poor business decisions. You may have poor decision making because of it or just poor reporting. So, what role does internal audit play in working with the IT department? And I guess, because it's a lot when I speak to companies is tell us what you're using and how you're using it? How it's integrated? What are you doing to improve that? And then secondly, that the next level now has been all this cybersecurity that's come into it. So, talk about the risk to businesses from IT itself?

Brent Brickman: Sure. So, when you have ... I look at this more in terms of a you can get faulty decision making that would come out of how your systems roll up. But you would also get ... You just have more infrastructure layered onto the company. So, the more different systems you have to operate, it effectively creates multiple control environments. It really does get centered around the big systems.

Brent Brickman: So, you're layering on cost doing that. And also to that cybersecurity point, this is something that really started to move up the top 10 list on audit committees in the last 10 years especially. The resilience that a company has against various types of cyber-attacks. And it's interesting to break that down too. You can get hackers out there that are just messing around, they just want to disrupt operations and send out viruses and see how far they can push those out. You'll also get people that want to infiltrate systems in a way to make people send cash their way. It's funny. And everyone's cash is the same. It's the same color.

Mike Alkin: Yeah.

Brent Brickman: And that's harder to control when you've got multiple different systems. You'll also have hackers and sometimes these are government sponsored where they're looking for your technology. They want to know your trade secrets. And there's been more stories about that in the news lately too with what's happening with US/China trade talks in particular.

Mike Alkin: Did you have ... and I know you spent a lot of time over there. Can you talk about what that environment is like?

- Brent Brickman:** Sure. It's certainly different than most environments I've been in. It's a developing economy so when you think about the people that I would interact with, a lot of them didn't really, especially more early on, didn't really have anyone that they learned from, per se. They kind of learned as they were going which is in a more established economy in the US or Canada or Europe, you'd have a mentor and then say okay, it works this way. So, there was that dynamic because things were just moving so fast. It was something to see. My first trip to China was in '95. Very different place 10 years after that.
- Mike Alkin:** Right.
- Brent Brickman:** In that environment, there was also more just a different view of intellectual property rights. And that truly is a case for ... it was really more possession is nine tenths of the law. If you didn't want me to know it, you shouldn't have shown it to me. That kind of thing. So, it was challenging from that standpoint. You would see, because the environment was different and also the legal system was different too, I'd say in terms of just recognition of those rights and what your legal remedies might be. You would see companies that might organize themselves a little differently just to be able to successfully operate in that environment so you could break things up a little bit more so it's harder to put the pieces together for local actors. That would be a strategy that the companies might use. But it is important, it's a different environment. You have to be aware of the environment that you're operating in and what you might do differently.
- Mike Alkin:** So, let's go take a step back. You're an internal auditor and you find something. You find channel stuffing. You find capitalization of expenses that should be ongoing. You find that they were selling assets and not getting the price but they were reporting higher prices. Whatever it might be. Walk us through what an internal audit executive does in that case. How does the information flow and get to the people that need to be aware of it?
- Brent Brickman:** In those whatever examples it would be, in those situations, you would be looking for really getting the facts to the extent that you can determine what they are. Is this an error? Did you have someone that was just really not competent for doing what they were supposed to be doing? And usually, the answer is going to fall into about half a dozen different buckets before you get to someone that's caught up in that fraud triangle. They have mode of opportunity and rationalization. They had some reason for doing it. They had the opportunity for doing it. And it was rationalized in some way.

- Brent Brickman:** So, let's say we get all the way down to that point. Now, you're really, at this point, you'd be talking to the people on your legal team and how you're collecting information. Because you're trying to determine do I have something that is criminal and may lead to working with outside law enforcement criminal prosecution? Or is it kind of low level fraud where you're not going to report it internally but maybe someone or a few people get fired? You have to use some judgment in terms of the size and what it is. If it's big enough, it will certainly go up to or should go up to the board through the audit committee and can be a discussion point with your external auditors.
- Mike Alkin:** I was going to ask you that. And what about lawsuits that are filed against the company? Some big companies have a lot of big lawsuits against them alleging a lot of stuff. Does internal audit review those lawsuits and what's the process that occurs there?
- Brent Brickman:** It will kind of depend on the, call it, the competence level of the internal audit function. I mean by what it's role in the company is. But oftentimes, if there's something like that, auditors would be deployed to go and do some fact gathering to be able to bring to the Feds against that type of situation and understand what's going on. There are such things as frivolous lawsuits where people are ... You know as well as I do, there's some firms that will just sort of ... they're looking to get paid to go away.
- Mike Alkin:** Yep.
- Brent Brickman:** But that's how auditors would jump into something like that. And it's important to know too that when you've got different things going on in a company, auditors are in a position where they can work with their internal counsel and they create an attorney/client privilege cover doing that too. Right?
- Mike Alkin:** Mm-hmm (affirmative).
- Brent Brickman:** So, those activities are not necessarily discoverable or easily discoverable. So, those are some of the types of things that you'd be thinking about as you're going down that path. But I would sort of come back to so much of this is human behavior and how people interact with one another in systems. And I interviewed a person once that I was convinced was lying to me about something. And I told that person's boss, I said, "Okay, I talked to this person and I think they're lying." And the boss said, "Well, I can't believe that person would number one, lie, or do anything that would be unlawful knowingly." And I was like what are you talking about? Everybody lies. Sorry, but right?

- Mike Alkin: And you're talking to an internal auditor.
- Brent Brickman: And number two, knowingly doing anything. Well, do you drive a car? Yes. Do you ever speed? Yes. Do you know what the posted speed limit is? Yes. Well.
- Mike Alkin: Right.
- Brent Brickman: You've got the motive, opportunity, and rationalization. Then it gets to the matters of degrees. Right?
- Mike Alkin: Yep.
- Brent Brickman: So, it becomes a study in that regard as well so well designed systems will go and try to remove opportunity, as an example, to reduce the level of fraud.
- Mike Alkin: That makes sense.
- Brent Brickman: Yeah.
- Mike Alkin: How is internal audit viewed within the corporation? Is it how the police would think about their internal affairs department? Is there a natural friction that is there? Is there a natural fear? What's the relationship?
- Brent Brickman: Well, there is a continuum and I would describe it more like on the one end, business partner, and on the other end, it's effectively corporate cop.
- Mike Alkin: Yes.
- Brent Brickman: And my personal view was to try to run it down the center. I mean, you need to be able to work with people internally. You need to demonstrate that you have partnering capabilities. But after all, you are all interested in making the enterprise a success. But on the other hand, you've got these fiduciary responsibilities and it's going to lead you to a place where there's going to be friction and conflict. So, I would tell people don't go into internal audit unless you're comfortable dealing with conflict.
- Mike Alkin: Yeah. You chose the wrong career path otherwise.
- Brent Brickman: Yeah. So, there is a balance there and I would say the pendulum has swung within that too. It went pretty far in business partnering and it ran pretty far back to corporate cop. And it does oscillate.

Mike Alkin: Yeah. Yeah. So, here you are now. You're home. Your wife is in med school and remarkable, doing great work, and pretty soon you're going to learn where your destination is. You've got your two elementary school age children and you spend your time looking, when you're not caring for them, looking at the markets and investing, trading. When you look at a company, and a lot of natural resource investors are on here, and Lord knows the natural resource space is the wild west of bullshit. They make it up as they go, say what they've got to say to go raise money to go put a drill bit in the ground, right? So, there's a lot of stuff there.

Mike Alkin: But let's break it down because you and I communicate a lot and we have standing jokes sometimes about guys who are like oh my God. What do you look at when you are looking at a company? Because you look at it through a different lens. Obviously, you look at it through the lens of an investor and the potential and the growth and where we are in the cycles and so on and so forth. But what are the things that you hone in on that the regular guy who's not doing internal audit might not when you're going through your risk assessment?

Brent Brickman: Sure. So I've, and as you mentioned, I'm juggling a few things so when I look at the market, I tend to look from a macro perspective first just to say does it look like this sector is going to be attracting capital or is it in liquidation? And as you break it down to the company participants, one thing that I've learned with this resource sector is everyone's gotten very good at telling their story. Right? I mean, they've got their pitches down. So, then you start thinking about well, what kind of red flags ... and I'm sure a lot of people, this will resonate with them. How many times has the story changed? Have they demonstrated any capability to do anything that they've said in the past? And certainly know where you are in the risk curve.

Brent Brickman: So, some of these companies are going to be viewed as being much more investible as others depending on whether ... Let's just take if we're looking at explorers or developers or producers, the closer they are to actually demonstrating that they can run a viable business and cashflow, that's going to attract a different type of capital than some of these others.

Brent Brickman: But I certainly look for those red flags. Does it make sense what they're saying and are they consistent with what they're saying? And sometimes things can change for valid reasons. But I look for those red flags first and if it kind of passes the sniff test from there, then I dig a little deeper and listen to what the companies

said about the Qs and the Ks. Gather more information that way. But it is the wild west in much of that space. Right?

Mike Alkin: It is. It is. And the more you talk with them, the more you can fall prey to the story. I find it much more helpful to know the story, listen to them. For me, it's going back and reading transcripts and watching old videos and presentations and just seeing how the story changes. Does it evolve with the current market environment? You could pick up things. And it's really a fascinating sector to follow because there is ... my gosh, they're throwing me a biotech companies in the sense that biotech companies exist to issue equity to go do research and development. Right?

Brent Brickman: Right.

Mike Alkin: And they dilute the living daylight out of shareholders. And the resource sector is very similar.

Brent Brickman: Yep.

Mike Alkin: Right. So, they exist to go put a drill bit in the ground, to go find something. And most of it is going to lead to nothing. Right? But they keep having people come back and do it. Yeah, so it's interesting. And it's also such a study in human psychology because when the cycle is down, everyone hates it. And when the cycle is up, everyone loves it. You catch those inflection points. So, yeah. It's fascinating.

Mike Alkin: So, what, sector-wise outside of resources, are there things that excite you or not excite you?

Brent Brickman: You know, outside of resources, I'm not that committed to much of anything. I'm in a kind of a position where I've got some assets deployed in what would be considered higher risk sector and then, I have other stuff that I've just parked. So, I'm just taking a ... it's called a barbell approach. I don't really ... I can't get too excited about the S&P and the broader market at this point. So, I'm just ... I like to look for relative value. So, if you look at commodities versus the S&P over the last decade, then you're going to see one is pretty high and one is pretty low.

Mike Alkin: Yep.

Brent Brickman: But that's me. That's a ... I like deep value. I like things that have been beaten up. I'm just not a momentum investor. And I've tried

to short, but Mike, I just can't do it. I don't know how to do it that well. I do it a little bit every now and then but I'm not that good at it.

Mike Alkin: It's hard. I mean, you have the DNA for it. I can tell you have the DNA for it because I know from speaking to you, you could figure out who's full of shit and who's not. But it is, look there's unlimited exposure, right? You could express it through puts. There's one way of doing it. Timing has to be more buttoned down on that front.

Mike Alkin: But for me, it's funny, because I didn't know better. When I started in the business, I'm kind of a naturally skeptical and cynical guy and I ask a lot of questions. And when I started, I was around guys who were hardened short sellers and it was you knew you were early because if you didn't see ... If everyone saw it, the stock price would reflect that. And so, you would do the work and it was all out in the field. Go out and do fieldwork. Who cares what the dopey Wall Street analysts say? Who cares what anyone says? Something showed up in the numbers that didn't make sense. Well, let's go investigate it. Let's put a mosaic of information together.

Mike Alkin: And sometimes you find it, sometimes you don't. When you don't, you go home. But I have to tell you, I've had my fair share of losers in my career on the long and short side. But I've had plenty of big winners on the long side and plenty of big winners on the short side. And man, those winners on the short side, when you can get a company that you just nailed because they were doing something that wasn't right, man, that's gratifying.

Mike Alkin: And it's funny because on the short side, people think oh, those nefarious short sellers. But they don't realize is those nefarious short sellers are not nefarious and they're out there holding companies feet to the fire.

Brent Brickman: Totally. It's really kind of misunderstood. And also, some of the rules were even set up to really be against short sellers. I don't know if it's still there but there are uptick rules.

Mike Alkin: Uptick rules, sure.

Brent Brickman: So, just a difficult thing to get the timing right. And knowing that there are so many forces trying to push asset prices up versus down.

Mike Alkin: That's the main thing, Brent. It's the money flowing. And over the

last 10 years really since the financial crisis and you've had funny money out there with the Fed printing money and just risk on. And it's made it really difficult to be on the short side. And you could see it. You could feel it. You could feel news that's reported that should cause a stock to go down that might temporarily go down and it comes right back up on certain names like there's just a flow of capital coming in so it's tricky.

Brent Brickman: And really understanding ... that's why I come back to some of the macro too and what kind of environment are we on? Is it risk on? Risk off? So, when we had the Fed saying that okay, we're going to raise interest rates and we're going to reduce the size of the balance sheet and then, they really changed their tune pretty quickly.

Mike Alkin: Yeah.

Brent Brickman: Right?

Mike Alkin: It was crazy.

Brent Brickman: Then you kind of go well, okay. The game has changed.

Mike Alkin: Absolutely. And you think about it, the little bit of ... the few raises we had and rates are still dramatically lower than they've been for history. And even that little bit of bumping up in rates caused the market to fall out of bed. And it makes you wonder just how precarious a position it is.

Mike Alkin: I've learned so many times long ago that trying to predict the direction of the market is really a fool's errand. But you can predict risk on or risk off. And meaning, do I want to have way more exposure to equities now than I did? Or than I might have had? Is there an appetite for risk or less or an appetite? And that kind of guides how I want to have net exposure to the market. It sounds like you think about it the same way.

Brent Brickman: Yeah. And I think people really do need to just don't fall in love with the story so much that you don't see some warning signs. So, if we think about one of the biggest corporate collapses in recent history being Enron, I remember back then reading in the paper that the CFO was effectively self-dealing with these special purpose entities. And it's kind of like okay, the company is totally uninvestable. You didn't really have to know that much more than that.

- Mike Alkin: Right. Yeah.
- Brent Brickman: And it still had a ways to fall from there. So, people can ... the signs are out there but if you're in love with the story, you're buying the dip, it's going to be harder for the change in psychology around it, I think.
- Mike Alkin: There was a ... and I'm going back, I'm testing my memory now ... probably 15 years, there was a resource company and I won't even say the sector, that had a technology that was supposed to be pretty good. And we had done a bunch of work, me and a couple of guys in my firm, and concluded that this was nonsense. That it wasn't going to work. But the story was great. It was really a good story but we just knew from people that had used the stuff, it wasn't happening. And we went and so, we did our fieldwork, got really comfortable, and said we've heard the management team at conferences. Let's go meet them. And you don't walk in and say hey, I'm shorting your stock. You say hey, we're interested in learning about the story. I'm an institutional investor.
- Mike Alkin: And showed up and it was literally community theater. This was a tiny company. And we show up and I think they had five people, maybe, at the company. Six people that you could find really because some of these companies were really small. But they had conference rooms and it was people overflowing. And the CEO would come in and talk to me and a couple of my guys and then they would say I've got to go. There's a contingent from another state, another country here, we're just ready to sign a deal. I'll be right back. And then, he would come back and he say sorry, I've got another meeting going on. Huge deal going to be signed. They had to be community theater. They had to go to the local theater and rent people.
- Mike Alkin: But you look back at the signs and sure enough, the CEO had had many legal problems. All the people associated with it had many legal problems which everyone overlooked until the company blew up and it went to nothing. So, yeah, the signs are there a lot of the times but if the story is good, people ignore the signs. They believe what they want to believe until proven otherwise.
- Mike Alkin: Well, it was great speaking, man.
- Brent Brickman: Yeah, I enjoyed it.
- Mike Alkin: Yeah. It was a lot of fun and hopefully your winter doesn't last too much longer there.

- Brent Brickman:** Hopefully not. It may be going for the record. We'll see.
- Mike Alkin:** Exactly. There is a guy I met through Twitter who actually happens to live in my hometown and he's from Minnesota and he was a major college hockey player. And he's friends with a bunch of the Islanders. He rooms with one of them while he's working in New York City and lives out here in my town. And I saw him at the game, the Islander game, the other night and I said what do you think of the weather? I said how is this compared to Minnesota? And he's like seriously? He's like this is like summer, dude. This is nothing. It's so cold there, you have no idea.
- Mike Alkin:** Well, but Brent, it was really great, and I enjoyed it. Thanks for taking the time to come on. I think people get a different perspective they don't hear, right? How often do they get to listen to what an internal auditor is doing.
- Brent Brickman:** Appreciate the invite. It was fun.
- Mike Alkin:** You bet, buddy. Take care.
- Mike Alkin:** I hope you enjoyed listening to Brent. I hope you enjoyed it as much as I enjoyed speaking with him. I don't think it's every day that you get to listen to an internal auditor who has had Fortune 500 experience. And to hear a different way to look and think about companies and some of the stuff that goes on within them that you should be aware of. It may not make or break your investment decision but it might help you form your mosaic of information.
- Mike Alkin:** So, hope you enjoyed it and I will speak with you next week. Thanks.
- Announcer:** The information presented on Talking Stocks Over Beer is the opinion of its host and guests. You should not base your investment decisions solely on this broadcast. Remember it's your money and your responsibility.

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