

**SPRING  
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**FIRST LOOK!**



*Over a span of 11 years, two California agricultural businesses were allegedly impacted by an embezzlement scheme perpetrated by their trusted bookkeeper, losing approximately \$5 million.*

**LOOK INSIDE TO FIND  
OUT THE KEYS TO A  
SUCCESSFUL FINANCIAL  
FRAUD INVESTIGATION**

# The Crime Times

## **INSIDE THIS ISSUE**

- Vendor Contractor Fraud
- 5 Keys to a Successful Financial Fraud Investigation





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## Vendor Contractor Fraud:

### **PREVENTION AND DETECTION TECHNIQUES**

There are several types of vendor/contractor fraud schemes that employees commit against companies while purchasing goods and services. Generally, they may be categorized as one of the following:

- Fictitious billings
- Over billings
- Conflicts of interest
- Payments made directly to the employee or to a company they control

The following prevention and detection methods, when used in combination, are effective in reducing the risk of these types of fraud schemes. The mere presence of unusual patterns or behaviors does not absolutely mean a dishonest act has been committed. The discovery of unusual patterns or behaviors does, however, suggest that further investigation is warranted.

## Recommendations

### **Prepare and provide written policies and procedures to employees.**

Management should prepare and provide written policies and procedures that clearly communicate guidelines relating to the selection and monitoring of vendors and contractors. It should also establish criteria for the preparation and approval of written agreements and payment procedures. Specifically, it is recommended that written policies and procedures include:

- Roles and responsibilities of an independent “Oversight Manager” who will ensure written policies and procedures are followed for every step of the process.
- Guidelines for when and how many competitive bids must be obtained.
- Description of the evaluation process used for accepting bids.
- Specify that all written bid solicitations include a detailed description of the type and amount of product/service provided.
- Require that written contracts with vendors and contractors are reviewed by the Oversight Manager and legal counsel.
- Specify who is responsible for monitoring and evaluating the performance of the vendor.
- Indicate how payment will be made to the vendor, and require dual signatures for check payments. Repetitive line numbers should be used for all wire transfers, and if there are one-off’s or a change in wire instructions, call back confirmation to the vendor should be done to a predetermined phone number you have on file.

### **All vendors and contractors should be screened.**

Prior to engaging any vendors or contractors, companies should perform screening procedures to ensure their integrity. Common screening procedures utilized are:

- Perform lien searches in the county where the vendor/contractor is located.
- Obtain credit reports from the national credit agencies.
- Request and contact business referrals.
- Obtain current financial statements.
- Obtain a listing of owners.
- Obtain relevant insurance policies.

For vendors and contractors used on a continuing basis, and for those who receive significant amounts of business, it is recommended that companies maintain a file for each vendor/contractor. The information contained within this file should be updated every year.

### **Maintain a master listing of qualified or pre-approved vendors.**

One method used to ensure the integrity of vendors and contractors is to pre-qualify them for inclusion on a master/contractor list. This will promote a quicker turnaround time during the selection process. The list should be reviewed annually, and vendors and contractors no longer being used should be purged.

Access to the list should be restricted to prevent unauthorized changes or additions. If the listing is online, the list should be password protected with a secure password.

### **Perform analytical reviews of selected company data and accounts.**

Companies should be alerted to concentrations of business with a few vendors and contractors. Additionally, certain patterns and behaviors may be observed that indicate anomalies that should be investigated. The following analytic review lists examples of the types of procedures that may indicate that a problem exists.

- Review the amount and percentage of business given to each vendor. A report or spreadsheet should be prepared that lists each vendor separately detailing the business received each year during the past 3 to 5 years.
- Review the timing of the receipt of vendor bids to determine if there's a vendor that always submits their bid last and is the lowest bidder.
- Review selected general ledger accounts where vendor and contractor payments are recorded. Select all individual entries greater than a predetermined threshold to ensure that all policies and procedures were followed.
- Using audit techniques, companies may efficiently analyze selected vendor data. Examples of audit techniques include:
  - List all vendors with P.O. address only, and then attempt to obtain physical mailing addresses for each vendor.
  - Compare vendor addresses to employee records (telephone numbers, email address, website addresses, social security numbers, tax ID numbers, etc.).
  - Review invoice numbers and amounts to determine if duplicate payments have been made to vendors.
  - Verify the physical location of the vendor to ensure they have a brick and mortar location.

### **Distribute certain company policies to all vendors/contractors.**

All companies should maintain policies concerning its code of ethics, conflicts of interest and fraud reporting. These policies should be distributed to all vendors and contractors with a cover letter identifying the name of someone within the company to contact in the event of suspected unethical or dishonest behavior.

### **Require annual financial interest disclosure statements from employees.**

Annually, employees should be required to complete standardized questionnaires regarding their financial interests and ownership in other entities. The entity names disclosed should then be compared to the vendor listing.

### **Periodically interview employees in key areas (purchasing, accounts payable, shipping and receiving, etc.) regarding vendor/contractor services and payments.**

Employees in the referenced areas may have noticed favorable treatment of certain vendors or contractors, poor quality of services provided, or higher than expected process. Although management may be unaware of these situations, unusual behavior or extravagant personal spending may be noticed by other employees.

### **Establishment of an anonymous Tip Hotline**

According to the 2018 Annual Report to the Nations on Occupational Fraud and Abuse, the initial detection of occupational fraud is a tip. This comes in at 40% of the time. As previously noted, employees in referenced areas may have noticed unusual or favorable treatment of vendors/contractors, or employees. The tipster may be more willing to contact someone using the anonymous tip hotline.



# Preventing Vendor Fraud

Prepare and provide written policies and procedures to employees.

Distribute certain company policies to all vendors/contractors.

Periodically interview employees in key areas regarding vendor/contractor services and payments.

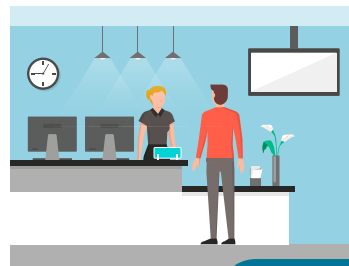
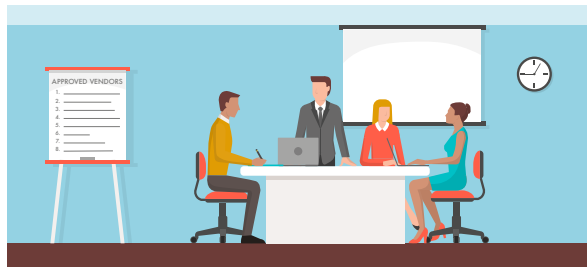
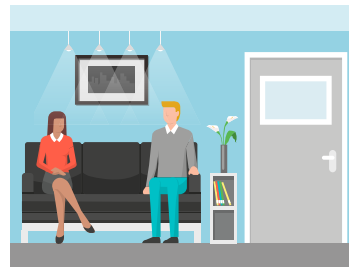
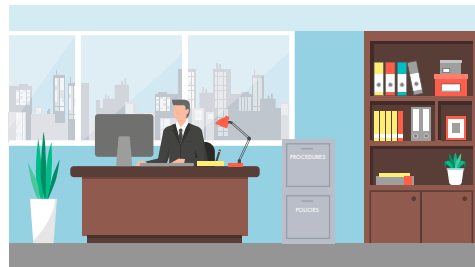
Maintain a master listing of qualified or pre-approved vendors.

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Establishment of an anonymous Tip Hotline



# 5 Keys to a Successful Financial Fraud Investigation

Megan Johnson, Lowers Forensics International - March 26, 2020

Over a span of 11 years, two California agricultural businesses were allegedly impacted by an embezzlement scheme perpetrated by their trusted bookkeeper, losing approximately \$5 million. Losses could have been far less had it not taken 11 years for the alleged crime to be uncovered. Yet, open any newspaper and you will commonly find stories of companies being victimized by fraudsters from within and outside the organization.

When an employer suspects occupational fraud (defined as fraud perpetrated by an employee) and/or files a claim with their insurer, that insurance company often turns to a forensic accountant to get to the bottom of the matter. To understand the elements of a successful financial fraud investigation, Megan Johnson, Senior Manager at Lowers Forensics International broke it down into five keys:

## 1. Gathering Background Information

In a recent case, Johnson says an employee for a retail operation with multiple locations was accused of allegedly skimming funds from the company. As the only accounting person in the administrative office, the individual was responsible for virtually all aspects of recordkeeping, from writing checks to reconciling accounts and processing payroll.

In order to fully understand what happened, forensic accountants will attempt to gather as much information as they can upfront. They seek to get the whole picture and confirm how the scheme was carried out. Usually, they'll start by speaking to the insurance adjuster to get basic details about the claim. They'll also review internal controls, collect relevant documentation, such as financial statements or employment files, and ask questions of other staff, vendors, and customers.

In the case of the retail operation, an obvious and important piece of background information was the lack of oversight and internal controls, specifically the segregation of duties.

In an ideal scenario, the forensic accountant interviews the alleged employee directly, but Johnson adds that most often they won't grant such conversations due to the ongoing investigation and risk of being found liable for the financial debt.

## 2. Knowing the Systems Involved

Skillful forensic accountants will have a good working knowledge of all of the major accounting software platforms and their accompanying loopholes. For example, the accounting platform used in this case allowed the user to input the name of one vendor into the software but altered that vendor name before the check was printed.

"It's also helpful to think like a criminal," Johnson says. "If I wanted to cover my tracks and hide evidence of my activities, how would I do it?" Those tricks might include changing names on checks, charging expenses to general line items (e.g., cost of goods sold), or reconciling accounts before anyone else sees the bank statements.

## 3. Obtaining Complete Documentation

Most organizations are more than happy to share any and all documentation they have in an effort to recoup their financial losses, determine how the theft was achieved and how to avoid potential future losses.

In other cases, employers may be reluctant to provide complete access to their records for fear of appearing culpable by maintaining no oversight of the employee and the "red flags" that were not further investigated at the time. For example, issuing back to back loans to the alleged employee to pay delinquent debt for years prior to the discovery of the potential fraud. "At first, this employer was hesitant to turn over their full financial statements, but once they did, it was easy to link the pieces together," notes Johnson. She continued, "The bank statements tied to the cleared checks which were made payable to the accused employee where the general ledger noted a different payee and was identified as a business expense. The employee had a very consistent and recognizable pattern in terms of the way the timing of the fraudulent checks were written."

#### 4. Understanding Job Functions

Many small businesses lack the financial resources or simply the awareness of what it means to have good internal financial controls. In the retail scenario presented earlier, there was no segregation of duties. The employee who wrote the checks was also responsible for reconciling accounts, reviewing invoices, paying the bills and processing payroll. This individual even had a rubber stamp with the owner's signature. No one was overseeing the work, and the individual was basically in charge of all things financial.

Johnson explains that most employees don't go in with the intention of stealing from their employer, but when an opportunity presents itself, or the employee is falling on hard times, sometimes they choose to take that step thinking they'll do it just this one time, no one will know and I'll pay it back when I can. In this case, the accused was a trusted employee who had been with the company for 10 years and was like family but had recently been faced with collections on several overdue loans.

#### 5. Following up on Internal Controls

Once an investigation has been concluded, a reputable financial forensics firm will work with the employer to implement internal controls to thwart future losses or potential theft by employees. These measures include such controls such as clear separation of duties, an audit department, diligent hiring practices, external audits, job rotation, and data monitoring technologies. A strong code of ethics and anti-fraud policies will also go a long way in preventing and detecting fraud.

At the end of the day, there is always a possibility an employee will steal from their employer and a resulting insurance claim will be filed.





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