

THE LINE IN THE SAND: FRAUD AWARENESS, PREVENTION, AND DETERRENCE

PROCUREMENT FRAUD: RED FLAGS AND INVESTIGATION TECHNIQUES

Procurement fraud continues to present a significant business risk for companies of all sizes. Employees use this scheme for a variety of reasons, including embezzlement of funds, receipt of kickbacks, and possible bribery and corruption schemes. This session aims to provide an overview of procurement fraud and methods to detect and investigate it.

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Paul E. Zikmund serves as Senior Director of Forensic Audit at Tyco International. He is responsible for providing fraud investigation, detection, and prevention services. He has nearly 20 years of experience in the field and has led global fraud and forensic teams at various Fortune 500 companies investigating complex financial frauds.

Paul, a Certified Fraud Examiner and Certified Fraud Deterrence Analyst, performs corporate investigations, investigative due diligence, provides corporate and government compliance and integrity services, and provides fraud risk assessments and fraud awareness programs.

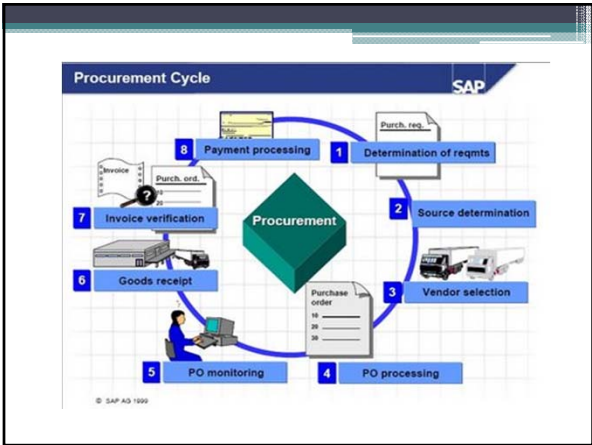
Prior to joining Tyco, Paul served in leadership positions at Amper, Politziner & Mattia, LLP, Solomon Edwards Group, LLC, and Deloitte and Touche, LLP, providing fraud and forensic investigative services. Previously, Paul served in a variety of in-house fraud and forensic investigative roles with The Dow Chemical Company, Nortel Networks, and Union Carbide Corporation. Paul began his career in law enforcement as a Municipal Police Officer, a State Trooper, and Special Agent with the Attorney General's Office in the Commonwealth of Pennsylvania.

Paul received a Bachelor of Science degree in the Administration of Justice from the University of Pittsburgh, a Master's of Business Administration from the University of Connecticut, and a Master's of Accountancy from Auburn University. Paul has authored various articles relating to fraud detection, prevention, and investigation. Paul speaks regularly at seminars and conferences on the topic of fraud and is an adjunct professor at Rider University in Lawrenceville, New Jersey, and LaSalle University in Philadelphia, Pennsylvania.

Paul is a former Board member of both the Philadelphia Chapter of the Association of Certified Fraud Examiners and the National Association of Certified Valuation Analysts Certified Fraud Deterrence Board.

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Procurement Fraud Red Flags & Investigative Techniques



Procurement Process

- Contracting to acquire goods or services
- Often based on relationships
- Decisions to acquire made objectively and subjectively
- Purchases dictated by company policies and procedures
- Conflicts arise between operations and financial controls
- Process is often challenged by various work-arounds

Procurement Fraud Defined

- Unlawful manipulation of the process to acquire goods or services to obtain an unfair advantage. (CPA Handbook on Fraud)
- Dishonestly obtaining an advantage, avoiding an obligation, or causing a loss to public property or various means during procurement process by public servants, contractors, or any other person involved in the procurement (wiki)

Fraud Is Pervasive

- 2010 Bi-Annual ACFE Fraud Survey
 - Estimated \$2.9 trillion in fraud losses
 - Median loss = \$160K (occ fraud), \$250K corruption
 - Average scheme = 18 months before detection
 - 24% reported fraud = billing schemes
 - Anti-fraud controls = reduced occurrences & losses
 - Highest risks = **purchasing**, processing transactions, and non-cash misappropriations
 - High-risk industries — banking, manufacturing, gov't

Types of Procurement Fraud

- Collusion between employees and vendors
- Vendors defrauding the company
- Collusion among vendors within an industry
- Employees defrauding their employers
- *Enforcement data from the National Procurement Fraud Task Force suggest that **bribery, bid-rigging, embezzlement, and submission of false claims** are the most common schemes.*

Forensic Investigative Techniques

Public Document Reviews & Background Investigation

- Complainant
- Employee(s) identified in the complaint
- Relevant third parties
 - Customers
 - Vendors
 - Competitors
 - Agents, Distributors, etc...

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Interviews of Relevant Persons

- Witnesses
- Management personnel
- Human resources
- Coworkers
- Related parties (vendors, customers)
- Employee(s)
- Other internal/external sources of information

Analysis of Physical & Electronic Evidence

- Document analysis
 - Forgeries
 - Alterations
 - Fictitious
- Computer forensics
 - Hard-drive imaging & reviews
 - E-mail analysis
- Data analytics
 - Statistical sampling
 - Journal entry reviews
 - Unusual patterns or data anomalies

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Analysis of Financial Transactions

- Analyzing manual journal entries
- Analyzing business trends and comparative data
- Calculating ratio analysis
- Bank statements, check deposits, payments
- Accounting entries
 - Example: sales returns and allowances for overstatement of revenue

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Procurement Fraud Schemes

Procurement Fraud Schemes

- Conflicts of interest
- Phantom vendor
- Split purchase orders/split orders
- Kickbacks
- Personal purchases
- Duplicate payments
- Defective products
- Product substitution
- Fictitious invoices
- Bribery/FCPA
- Bid rigging

Wake County Schools

- Between July 1, 2002, and December 31, 2005, Wake County School employees in the school transportation department and Barnes Motor & Parts Co., based in Wilson, NC, submitted at least \$3.8 million in fraudulent invoices for school bus and automotive parts. Much of the money was used by the employees to buy personal items, such as automobiles, campers, golf carts, and plasma-screen televisions.
 - Payments to Barnes Motor increased by \$3,700,000 in one year.
 - 2/3 of all invoices to Barnes were under the \$2,500 limit.
 - 50 or more invoices had the same invoice date on over 24 occasions.
 - 466 invoices were submitted on the same date just prior to year end.

Boeing

- Darlene Druyun, Senior Executive with the DoD, obtained jobs at Boeing for her daughter, daughter's fiancé, and herself while negotiating a contract with Boeing.
- She agreed to pay a higher price than appropriate for Boeing's tanker aircraft.
- Boeing's CFO also played a key role in the fraud.
- Sentenced to nine months in federal prison for her part in a conspiracy to assist Boeing in a tanker lease contract while negotiating a job with them, in violation of 18 U.S.C. § 208, which deals with personal financial conflicts of interest.

Phantom Vendor

Description:

Employee establishes a fictitious vendor and submits false invoices for payment (or invoice may not exist to support payment)

Indicators:

Photocopied invoices, lack of invoices to support payments, employee address matches vendor's address (ACL testing)

Conflict of Interest

Description:

Misusing position to award contracts to firms in return for personal gain (money, family employment, or other gratuities)

Indicators:

Lifestyle changes, refusal to change vendors, failure to enable bidding procedures, continuous use of same vendor, significant increase in pricing, increase in product complaints, decline promotions

Duplicate Payments

Description:

Duplicate payments made to a vendor without services rendered to justify the second payment. This fraud is normally committed by a vendor with collusion with an employee.

Indicators:

Multiple duplicate payments of the same or similar amounts to a vendor and/or for the same invoice # (ACL testing)

Kickbacks/Improper Payments

Description:

Often facilitated through accounts payable, a company or individual submits an invoice for services that never occurred. Or the invoice submitted is inflated by the amount of the kickback sent to the conspiring employee.

Indicators:

- Paid invoices that lack additional appropriate supporting documentation
- Growing frequency of purchases from one vendor
- Award contracts without bids
- Increase in services, continued use of same vendor

Vendor Master File Manipulation

Description:

Employee modifies current Vendor Master File information.

Indicators:

Unapproved and/or unnecessary changes made to the Vendor Master File or changes that lack any support. Look for tampering with vendor name or vendor address, for example.

Product Substitution

Description:

Misusing position to award contracts to firms in return for personal gain (money, family employment, or other gratuities).

Indicators:

Lifestyle changes, refusal to change vendors, failure to enable bidding procedures, continuous use of same vendor, significant increase in pricing, increase in product complaints

Bid Rigging

Description

Bid rigging is a form of collusive price-fixing behavior by which firms coordinate their bids on procurement or project contracts, including arrangement of bidding process to guarantee selection of vendor

Indicators

- Allowing rebids to selected vendors
- Rotation of bids
- Supplying faulty/inferior materials
- Excessive control over selection process
- Continuous use of vendor without business reason
- Increased pricing
- Substandard products

FCPA

Description

U.S. companies making corrupt payments to foreign officials for the purpose of obtaining or keeping business. The FCPA makes it illegal for any U.S. citizen or firm to use a means of U.S. interstate commerce to offer, pay, transfer, promise to pay or transfer, or authorize a payment, transfer, or promise of money or anything of value to any foreign appointed or elected official, foreign political party, or candidate for a foreign political office for a corrupt purpose

Indicators

- Excessive or improper entertainment or gifts
- Cash payments
- High commission payments
- Payments to subcontractors when no work is performed
- Failure to follow third-party controls

Audit Considerations

- Who has access to modify the Vendor Master File?
- Are changes made to the Vendor Master File without approval or support?
- Is there periodic review of the Vendor Master File and edits made to the Vendor Master File?
- Is there proper segregation of duties?

Audit Considerations

- Is supporting documentation reviewed for all payments to vendors?
- Test detailed transactions
- Examine supporting documentation
- Interview employees

Procurement Fraud Red Flags

- Unusual or unauthorized vendors
- Large gifts and entertainment expenses
- Unusual increase in vendor spending
- Round-dollar amounts
- Copies of supporting documentation in lieu of originals
- Duplicate payments
- Tips and complaints

Procurement Fraud Red Flags

- Sequential invoices paid
- Unusual/large/round-dollar amounts paid
- Payments just under authorization level
- Employee-vendor address match
- Multiple invoices paid on same date
- Slight variation of vendor names

Case Studies

BMD Welding

- A call is made to the Concern Line from a contractor claiming he performed work at the private residences of a Tyco employee but billed Tyco for the services. He provides invoices and the name of the employee as evidence to support his allegation.

1. What are your first steps in the investigation?
2. What company policies are impacted by this allegation?
3. What evidence would you need to prove this allegation?

Like Father, Like Son

- A call is made to the Concern Line from a subcontractor. The caller is the owner of a company who previously installed security systems in a subcontracting capacity for your company. The caller states that one of your project managers hired his father's company to perform the work at inflated prices and that the work is substandard. The caller is also angry about no longer being provided work.

1. What are your first steps in the investigation?
2. What company policies are impacted by this allegation?
3. What evidence would you need to prove this allegation?

Karaoke Bars

- There is an audit of T&E expenses of a business that sells products to government customers. During a review of a sales manager's T&E expense reports, you discover several unusual receipts. Some are clearly copies and others appear to be restaurant receipts with sequential receipt numbers. Other receipts show amounts for dining to be extremely high.
 - You further discover that he has dined with several members of one of your best customers, a government entity. Another employee informed you that the sales manager hires agents and distributors to manage this relationship.
1. What are your first steps in the investigation?
 2. What company policies are impacted by this allegation?
 3. What evidence would you need to prove this allegation?

Questions??
