

Strengthening Internal Controls to Prevent Fraud

Presenters



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About DHG



2,000+

People, including
250 Partners
/ Principals



TOP 20

One of the top 20
largest accounting
firms in the U.S.



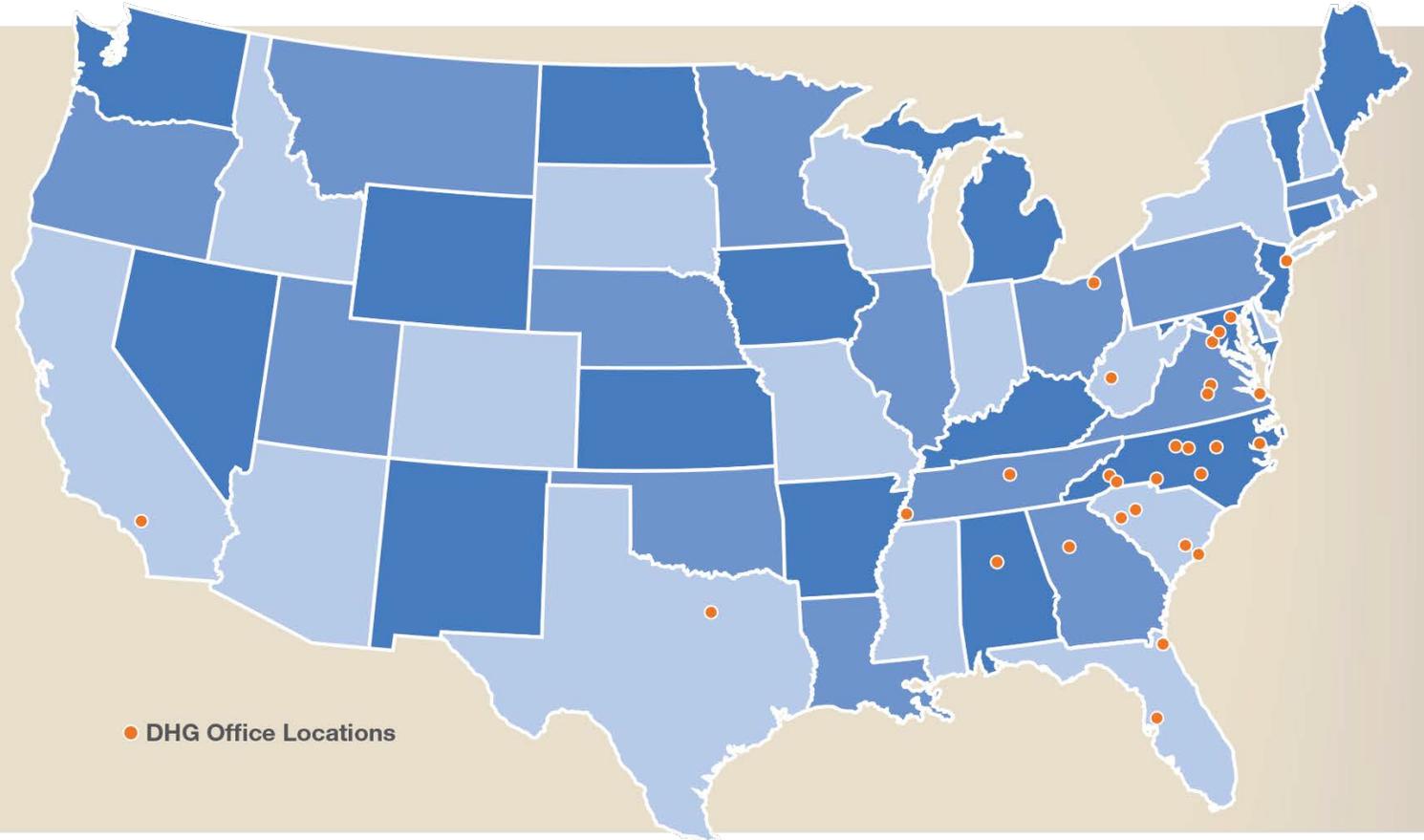
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States with offices
that serve clients
across the U.S.



50

Serving clients
across all 50 states
and Internationally



About DHG Dealerships

3,000+

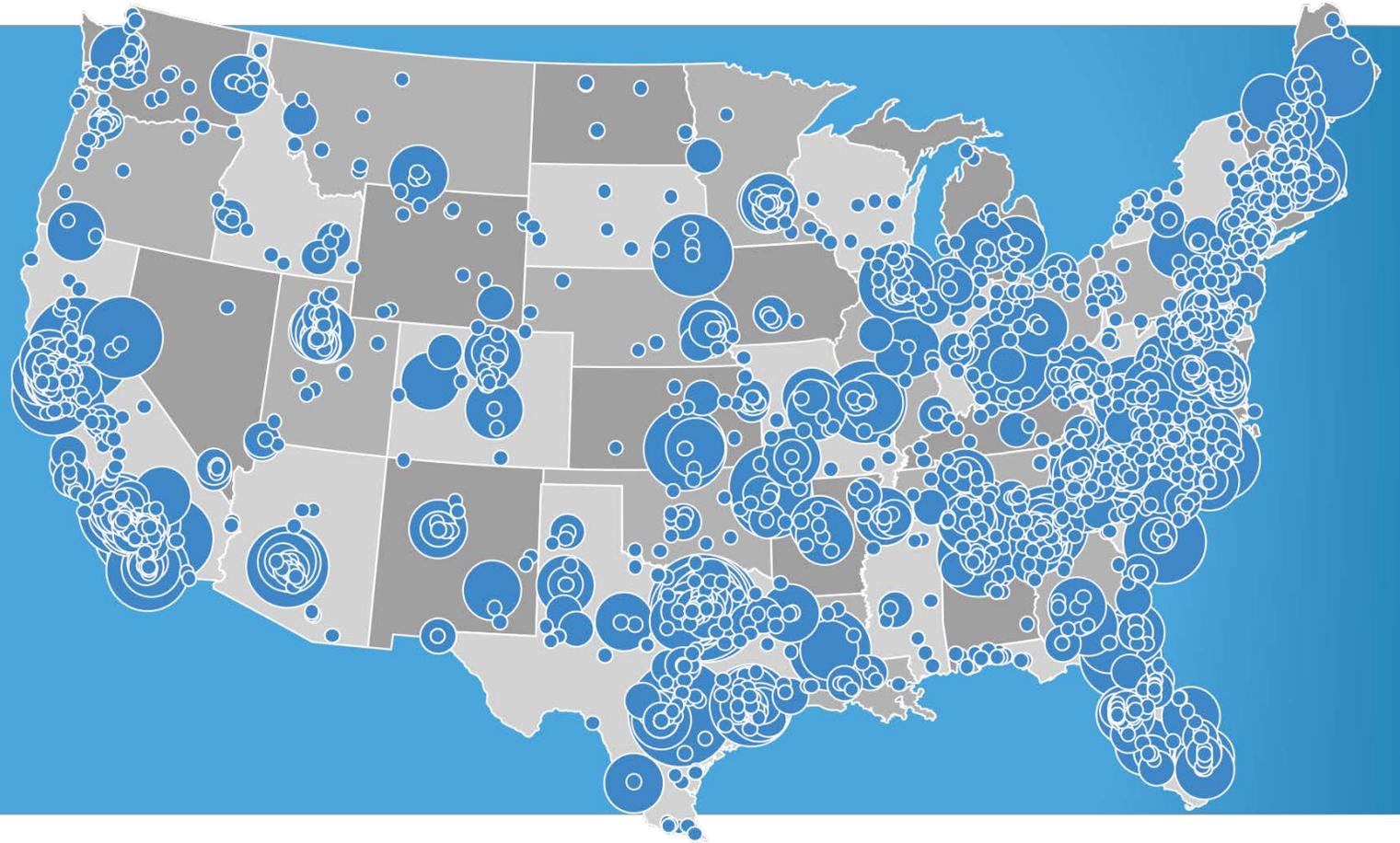
Dealership Clients Served

160+

Dedicated Dealerships
Professionals

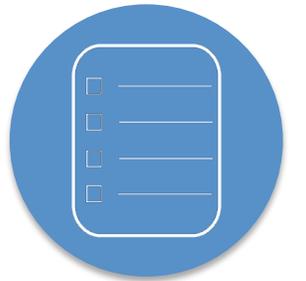
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States with Dealership Clients



Overview

- Business Fraud Statistics
- Fraud Theory
- Perpetrator Profile
- Fraud Examples
- Internal Control Examples
- Action Plan



Family and Employees

Everyone always wants more...





Statistics on Business Fraud

Statistics on Business Fraud

- A typical organization loses approximately 5% of its annual revenues to fraud- up to \$3.7 trillion world-wide
- **Over 50% of employees committing fraud have been with the organization for 5+ years**
- \$250,000 is median loss for employees having 10+ years with the company
- Median loss is \$150,000



Statistics on Business Fraud

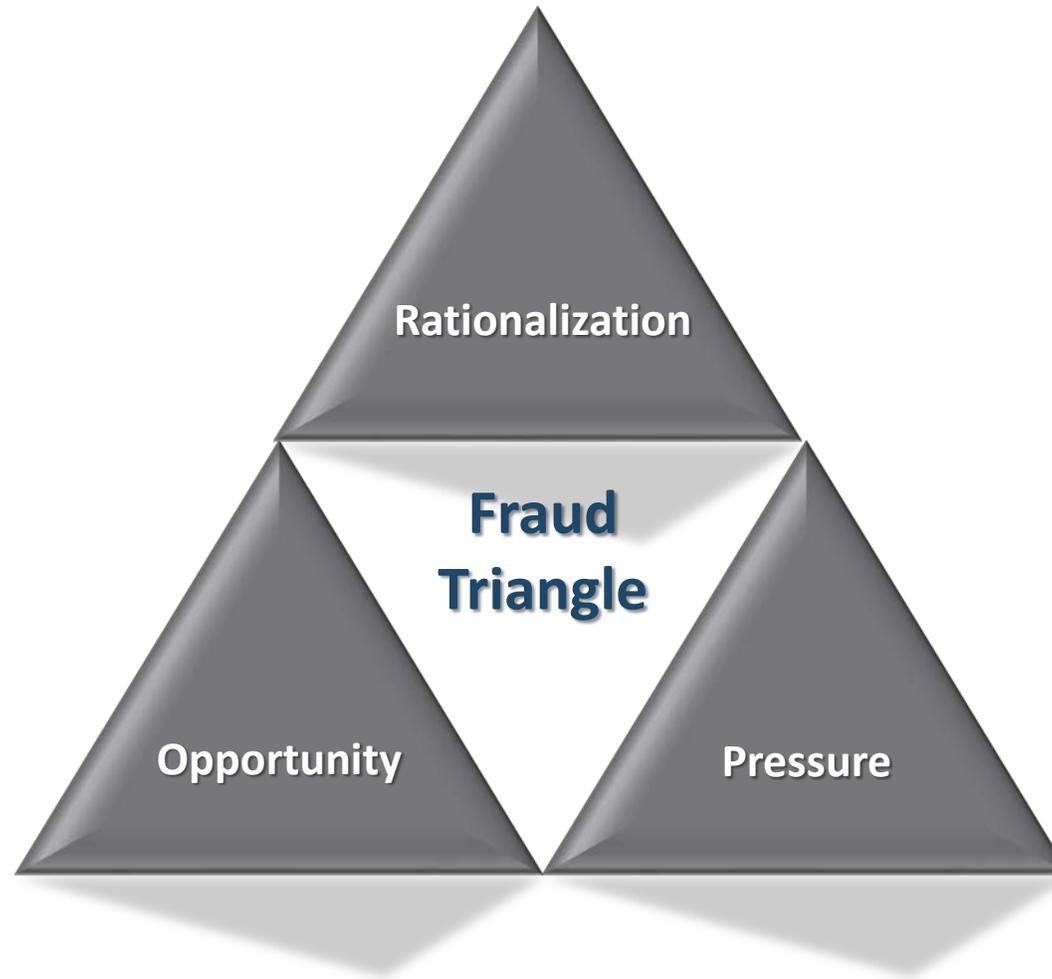
- Median length to detect fraud is 18 months
- 83% of fraudsters had never been charged/convicted of a fraud-related crime
- 58% of fraud cases have no recovery at all
- Over 40% of all cases were detected by a tip from an employee



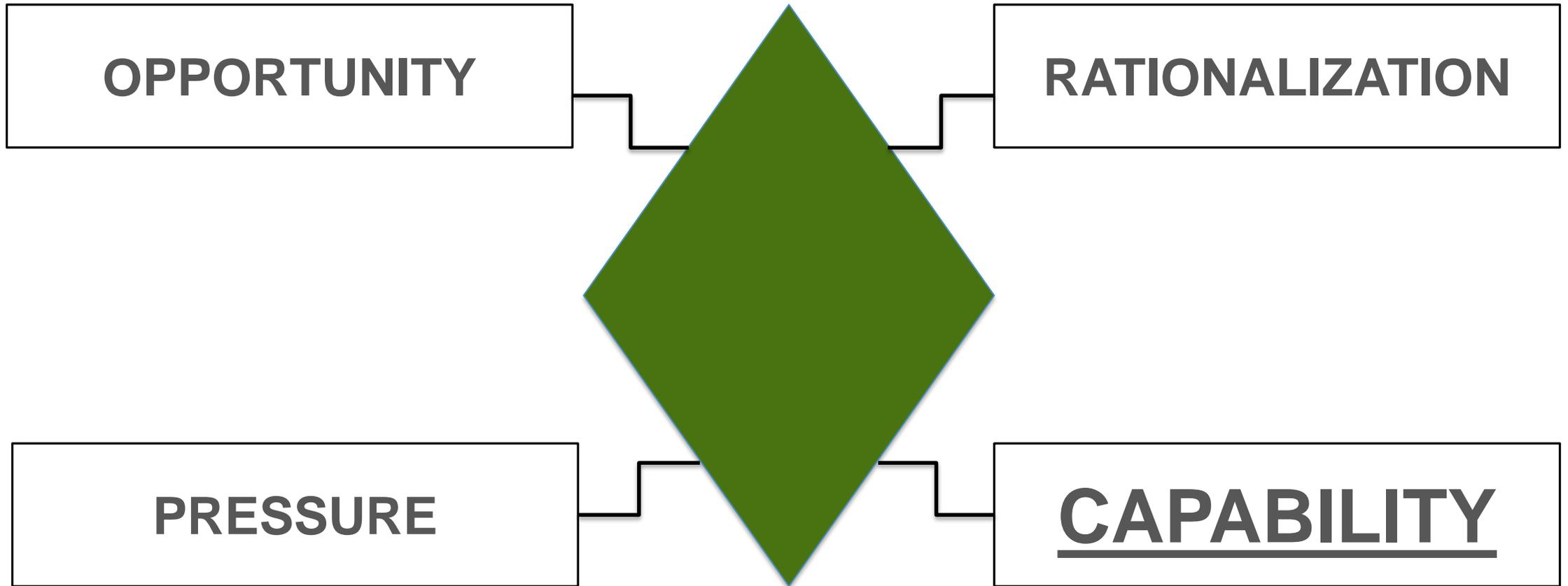


Fraud Theory

The Gateway to Fraud



Fraud Diamond



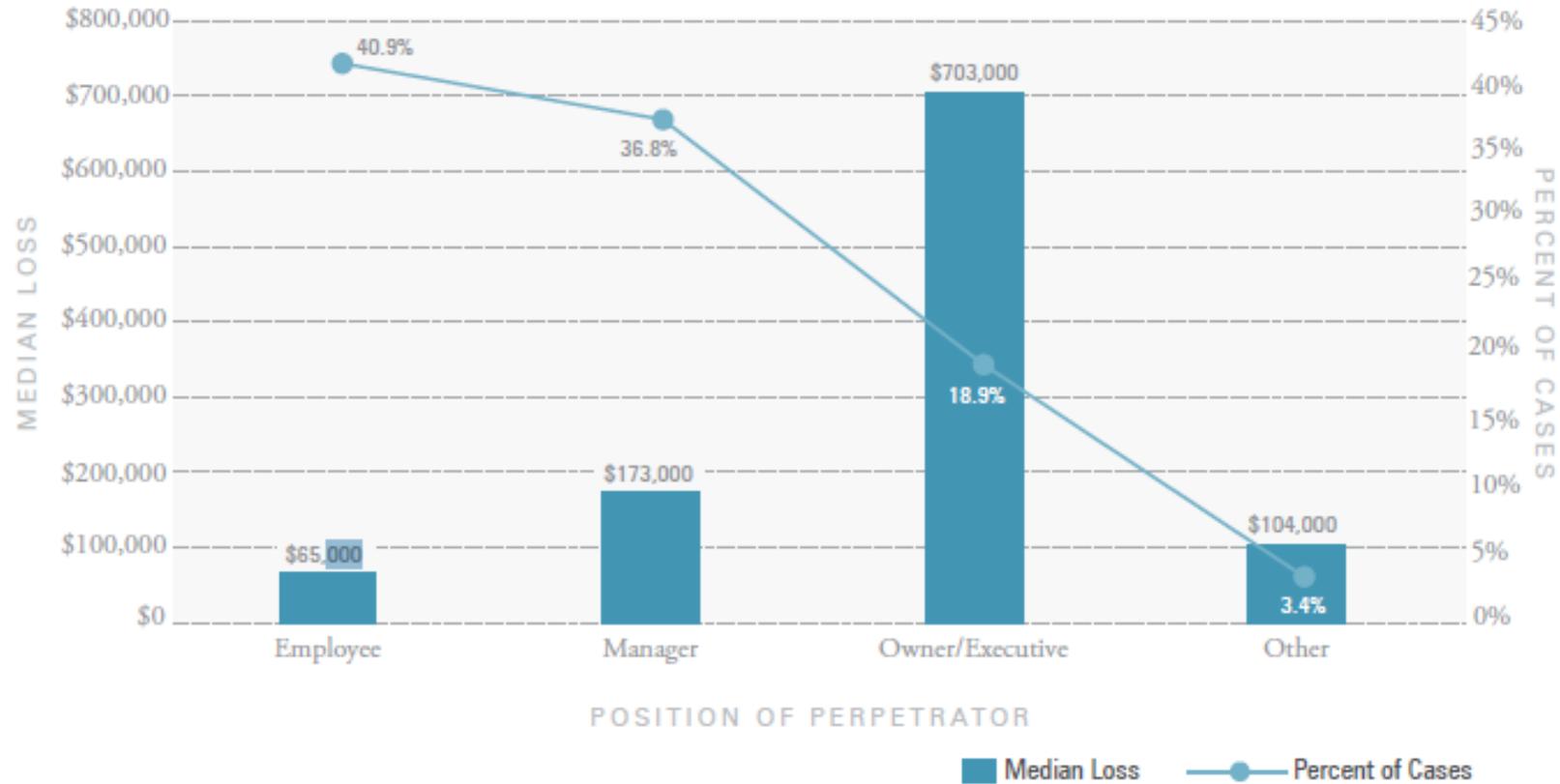
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DIXON HUGHES GOODMAN LLP

Perpetrator Profile

Perpetrator Profile

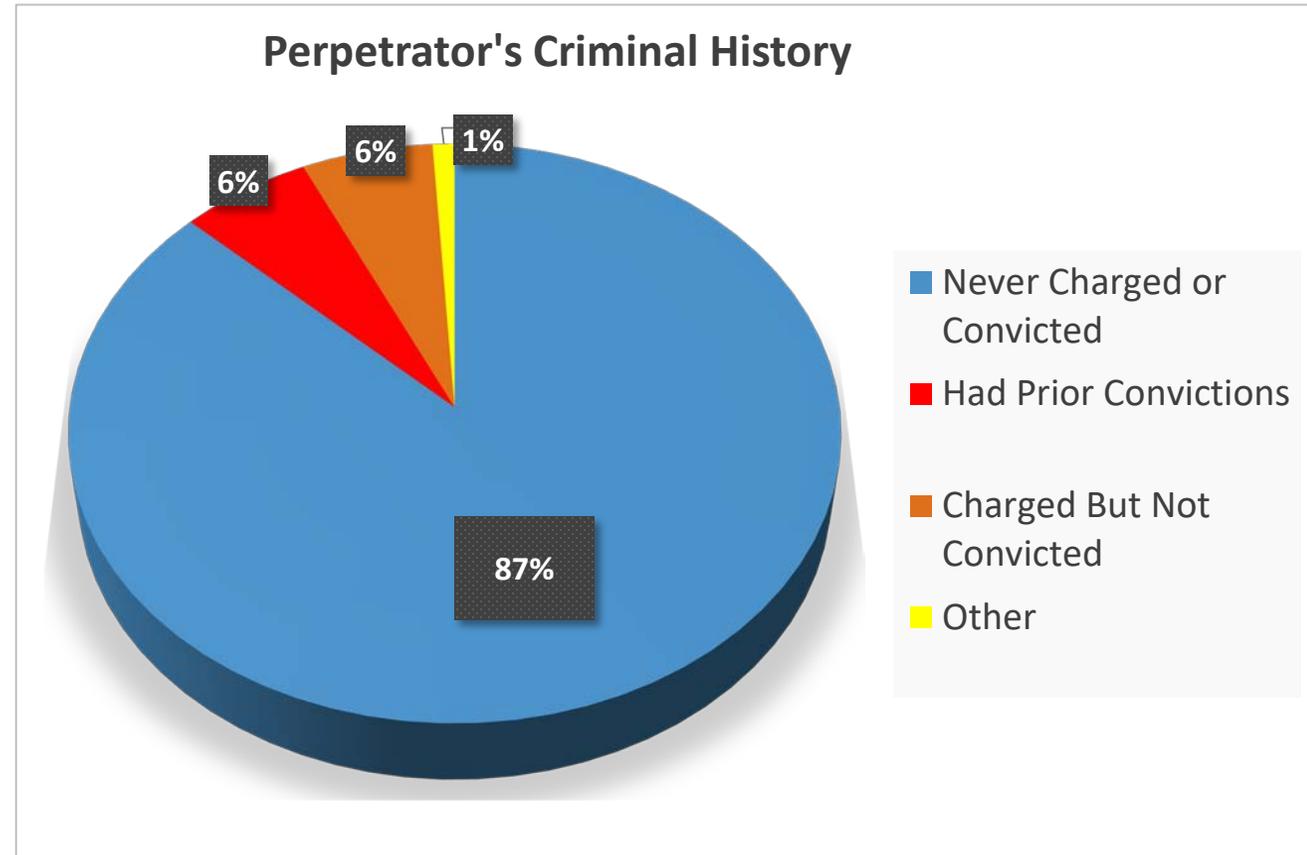
Figure 65: Position of Perpetrator—Frequency and Median Loss



- Only 18.9% of frauds were committed by owners/executives, but the median loss in these cases was \$703,000.
- Employees and managers were much more likely to commit occupational fraud, but the losses in these schemes were much lower—though still substantial.
- High-level fraudsters tend to have greater access to their organizations' assets than lower-level employees, as well as a better ability to evade or override anti-fraud controls.

Perpetrator Profile

- Behavioral Red Flags:
 - + Living beyond means
 - + Financial difficulties
 - + Wheeler-dealer attitude
 - + Unwilling to share duties
 - + Unusually close relationship with vendor
 - + Divorce or other family problems

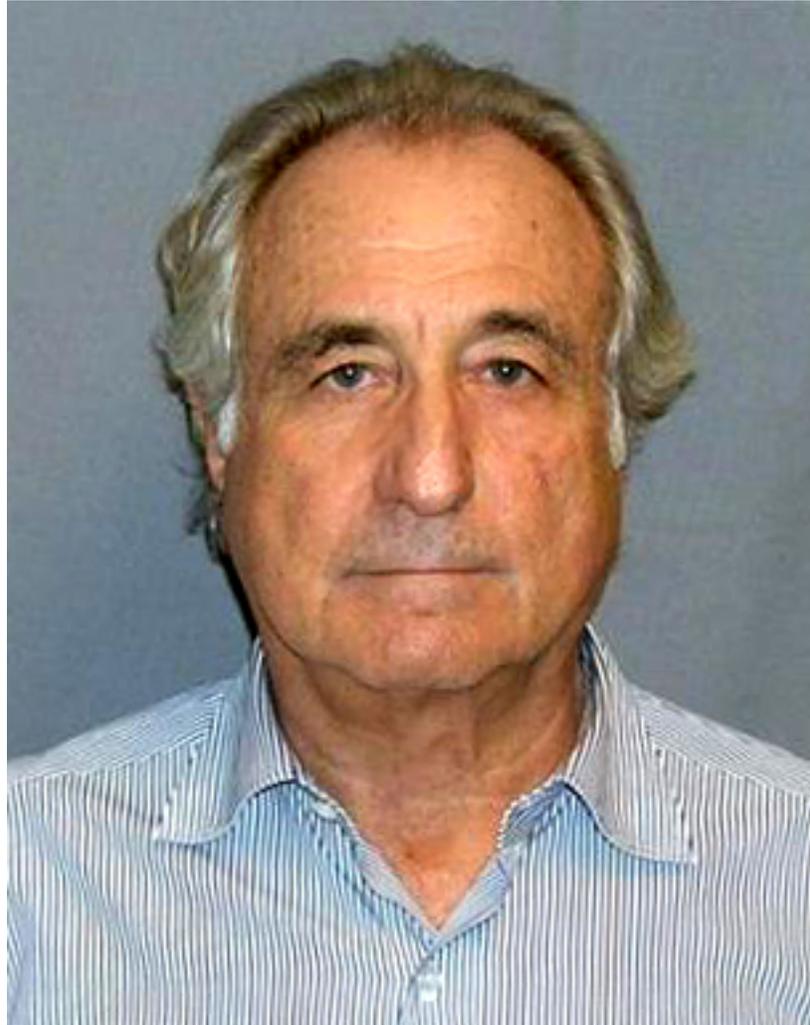


Conflicting Points

- You can't transact business without relying on an element of trust with your employees
- Theft usually occurs by your most trusted employees
- Building a culture of accountability creates the right level of trust and mutual benefit
- **Trust is not a control**



What We Think of When We Hear Fraud



“In today’s regulatory environment, it’s virtually impossible to violate rules.”

~ Bernie Madoff (in 2007)

What We Should Think Of



Vendor Fraud Case

- Employee printed unauthorized business checks from her employer and deposited them into personal and business accounts
- She used similar names as legitimate vendors
- Sent forged letter to DMS provider to grant full administrator privileges to cover her tracks
- Total loss = \$1.2M

General Manager Fraud

- GM worked at the dealership for over 13 years (knew owner for 36 years)
- Also worked as finance manager
- Owner's wife discovered the fraud after going through cash receipts files and something "looking off"
- Total loss = \$362,000

Controller Fraud

- Controller began embezzling 50 business days after being hired
- Dealership president quoted “She thrived on making it seem like she was being the hero and pointing out our flaws to improve them, while she was seeing the opportunities of how to steal from us.”
- First class vacations to Hawaii, Jamaica, Australia and Mexico
- Total loss = \$1.1M
 - 65 EFT’s totaling over \$900,000 sent directly to her personal account
 - 28 checks totaling over \$200,000 used to pay her personal credit cards
 - Over \$31,000 in expense reimbursements



Fraud Examples

Cash Fraud Examples

- Cash Disbursement Fraud
 - + Fictitious Vendors
 - + Personal Credit Card Payments
 - + Mortgage Payments
 - + Personal Expenses (including gas cards)
 - + Spiffs
- Cash Receipt Fraud
 - + Skimming
 - + PayPal
 - + Lapping

Parts Fraud Examples

- Stealing Parts
- Vendor Kickbacks (prepaid debit cards)
- Cost Adjustments
- Credit Memos
- Open Parts Tickets
- eBay
- Swapping Parts on Used Cars
- Scrap Metal
- Re-aging

Service Fraud Examples

- Skimming
- Employee Purchases
- Unauthorized Discounts
- Fuel & Oil Additives
- Sublet Jobs
- Open Repair Orders
- Expense Categorization

F&I Fraud Examples

- Payment Packing
- Power Booking
- Falsifying Credit Applications
- Wholesale Transactions

Payroll Fraud Examples

- Pay Plan Manipulation
- Hourly Rate Discrepancies
- Ghost Employees
- Flag Hour Adjustments
- Expense Reimbursement
- Withholdings
- Benefits

Not Always Internal Either...

- Checks
 - + Counterfeiting
 - + Alteration
- ACH
 - + Phishing
 - + Malware
- Credit cards
 - + Employee colluding with 3rd party



Internal Controls

Internal Controls

Internal controls is a **PROCESS** -- designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- reliability of financial reporting,
- effectiveness and efficiency of operations, and
- compliance with applicable laws and regulations.



Components of Internal Control

- What are your current processes?
- What risks do those processes pose?
- What steps or controls are in place to mitigate those risks?
- If issues are noted, how are those communicated and addressed?
- How does management ensure those steps to mitigate related risks are being performed?



Segregation of Duties



Segregation of Duties

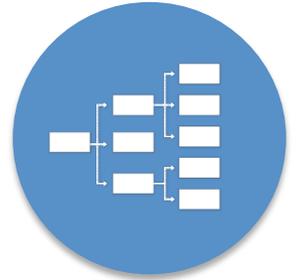
Example SOD matrix

Employee/Title	Authorization			Custody of Assets					
	Write-offs of uncollectible accounts	Authorizing new A/P Accounts	Signing of checks	Opening mail	Handling of receipts of currency	Preparation of bank deposit	Mailing of checks	Access to cash drawer	Access to safe

Segregation of Duties

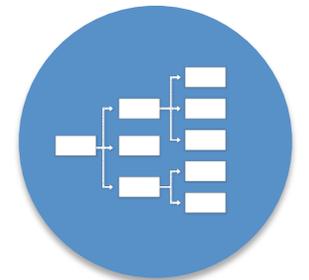
- Separate key functions –
 - + Authorization
 - + Custody
 - + Record keeping
- Rotate functions, require mandatory vacations
- Get the dealer active in the internal control function

Collusion is one of the most difficult forms of fraud to detect



Segregation of Duties

- Examples:
 - + Cash receipts – opening the mail/handling cash should be separated from posting to the general ledger and reconciling cash
 - + Cash disbursements – preparing the check/disbursement and approving them should be separated
 - + Vendor creation – separating the function of creating vendors and posting/paying vendors



“I look for 3 things in hiring people. The first is **personal integrity**, the second is **intelligence**, and the third is a **high energy level**. But, if you don't have the first, the other two will kill you.”

~ Warren Buffet

Information/Communication & Monitoring

- Quality and relevant information is key
- Communication throughout the whole organization
- Give employees the tools and training to do their jobs effectively
- Don't establish controls and forget about them



And Always Ask Yourself...

- How would I instigate a fraud scheme?
- Did cost cutting create weaknesses in my internal controls?
- Do I have an accounting policy manual?



Internal Controls Can Help You Prevent This...

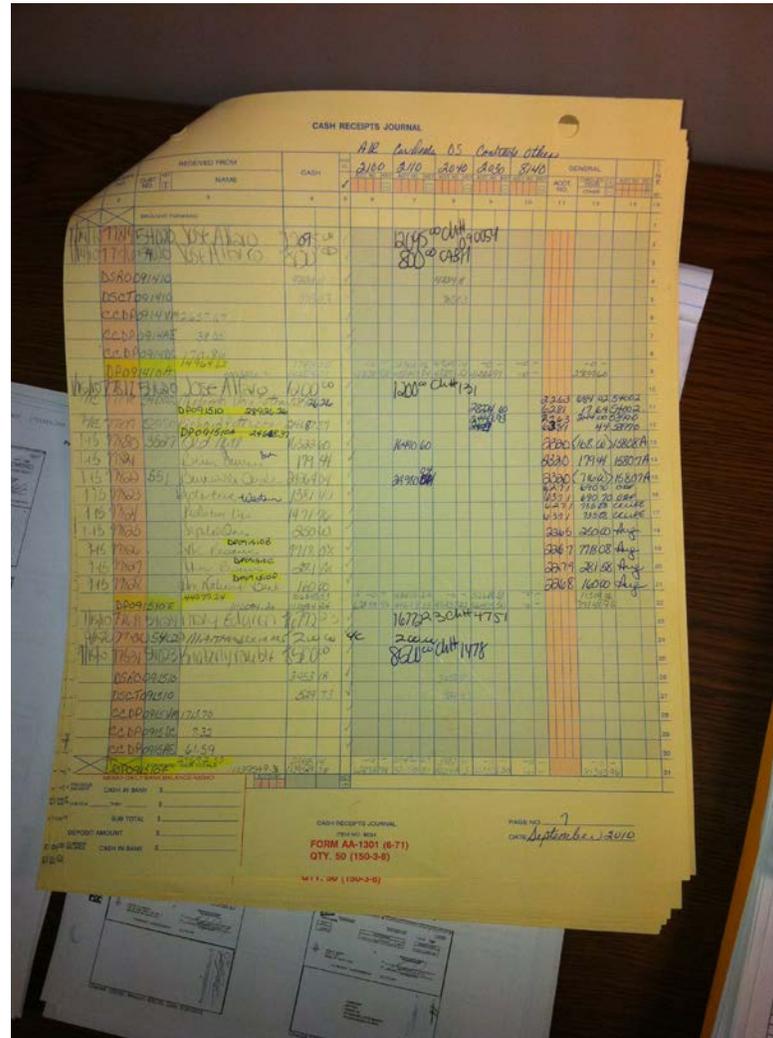


“Our books are balanced. 50% of our numbers are real and 50% are made up.”



Action Plan

Effective Control?



Control Activities

- Cash Controls
 - + Prevent undesirable events from occurring:
 - Check signers/dual signatures
 - Restrictive endorsements
 - Positive pay
 - Segregation of duties
 - Restricted DMS access
 - Journal entry review
 - Daily bank reconciliations
- Month-End Controls
- Detail schedule review
- Management review of financial statements

Control Activities

- Parts Controls
 - + Prevent undesirable events from occurring:
 - Independent physical
 - Restricted access to department
 - Password protection
 - Notify vendors of dealership policy
- Month-End Controls
 - + Parts pad vs. G/L reconciliation
 - + Review of:
 - Parts management report
 - Open parts tickets
 - Parts pending
 - Special order parts
 - Parts override report
 - Loaner vehicle tracking

Control Activities

- Service Controls
 - + Prevent undesirable events from occurring:
 - Segregation of duties
 - Password protection
- Month-End Controls
 - + Review of:
 - Open repair orders
 - Exceptions report
 - Gross profit analysis
 - Policy expense

Control Activities

- Payroll Controls

- + Prevent undesirable events from occurring:

- Segregation of duties
 - Restricted DMS access
 - Approval for edits

- Month-End Controls

- + Review of:

- Personnel expense analysis
 - Manager bonus calculations
 - Payroll registers
 - All changes made to master payroll profile

Don't Be Caught



Recap

- Fraud is happening in your dealership
- Identify your high risk areas
- Develop an action plan
- Perform a risk analysis
- Implement policies and controls
- Inspect what you expect





Questions?