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FOCUS ON FRAUD: The Series Continues...
Employee Fraud,
From Discovery to Recovery

March 20, 2012

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REMINDERS

- In order to receive participation credit, you must:
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TODAY’S PRESENTERS

Glenn Pomerantz, CPA, CFE

- 28 years of forensic accounting, auditing and consulting experience
- Co-chairs BDO’s US Anti-Corruption Compliance and Investigations practice
- Conducts 15-20 employee dishonesty investigations annually including fidelity bond claim matters
- Designs, implements and monitors anti-fraud compliance programs
- Conducts FCPA and other regulatory transaction advisory due diligence

Education
- M.B.A. Finance, Baruch College - City University of New York
- B.S., Accounting, State University of New York at Buffalo

Joseph Perry

- Senior Vice President, Chartis Fidelity Bond Claims
- 32 years of Fidelity Bond claim experience

Education
- J.D., University of Baltimore
- B.A. Political Science, University of Maryland Baltimore County
TODAY’S PRESENTERS

Brian O’Neill
- Executive Vice President & Senior Fidelity Officer for Chartis, Executive Liability
- Responsible for the underwriting of all Fidelity and Crime products underwritten within Chartis - Executive Liability
- 28 years of Fidelity and Crime underwriting experience

Education
- B.B.A. Finance, Iona College, New Rochelle, New York

TODAY’S AGENDA

1. Common Business Exposures to Fraud
2. Workplace Fraud Controls
3. The Impact of Fraud on Business - Statistics
4. Examples of Fraud in the Workplace
5. Investigating Fidelity Losses
6. Fidelity Insurance Coverage and Solutions
7. Chances of Recovery in the Event of Fraud

1. COMMON BUSINESS EXPOSURES TO FRAUD

What is Fraud at the Workplace?

It is the use of an employee’s position within the company to:
- Steal company money or property; OR
- Receive kickbacks or bribes from suppliers, vendors, or customers
1. COMMON BUSINESS EXPOSURES TO FRAUD
Types of Fraud

- Employee fraud
- Forgery
- Robbery
- Funds transfer fraud
- Safe burglary
- Agent theft
- Computer fraud
- Theft of confidential and personal identification information

2. WORKPLACE FRAUD CONTROLS
A. Regulatory Requirements

i. Sarbanes-Oxley ("SOX") Act of 2002
   - Section 404: Assessment of the effectiveness of internal control structure and procedures for financial reporting
   - Materiality considerations
   - Section 304: Clawback of compensation from CEOs and CFOs of companies engaged in accounting misconduct

ii. The Dodd-Frank Act
   - Section 922 of Dodd-Frank added new Section 21F to the Securities Exchange Act of 1934
   - Eligibility for awards: provides original information about a securities violation leading to the successful enforcement of an action brought by the SEC that results in monetary sanctions exceeding $1,000,000
   - Eligible whistleblowers entitled to an award of between 10% and 30% of the monetary sanctions collected
   - Section 954: SEC to require issuers to enact clawback policies that allow issuers to recover incentive-based compensation from current or former executives.
2. WORKPLACE FRAUD CONTROLS
   A. Regulatory Requirements (continued)

   iii. Amended Sentencing Guidelines
       [U.S. Sentencing Guidelines Manual]
       • Section BC2.5(f): Reduction in “culpability score” with an effective
         compliance and ethics program
       • Section BB2.1(b): Importance of remediation efforts

2. WORKPLACE FRAUD CONTROLS
   B. Lack of Internal Controls

   i. Lack of segregation of duties
   ii. Absence of independent review
   iii. Non-existent internal audit function
   iv. Lack of an anonymous reporting hotline
   v. Ineffective/insufficient background checks

2. WORKPLACE FRAUD CONTROLS
   C. Breakdown of Internal Controls

   i. Poor tone at the top
   ii. Override of existing internal controls
   iii. Human error/lack of competent personnel
   iv. Collusion that undermines prescribed internal controls
   v. Deficient communications of policies and procedures and other
     internal controls
2. WORKPLACE FRAUD CONTROLS
D. Preventive Measures

i. Periodic fraud risk assessments

ii. Fraud controls
   • Segregation of duties
     ➢ Record
     ➢ Reconcile
     ➢ Custody of assets
     ➢ Authorization
     ➢ Continuous monitoring

2. WORKPLACE FRAUD CONTROLS
D. Preventive Measures (continued)

ii. Fraud controls (continued)
   • Human error / Training
     ➢ Strengthen the weakest link
   • Background checks

iii. Internal audit
   • Periodic assessments of adequacy of internal audit procedures
   • Authority and independence
   • Availability of qualified and experienced resources

3. IMPACT OF FRAUD ON BUSINESS - STATISTICS

Association of Certified Fraud Examiners 2010 Report to the Nations

• A typical organization loses 5% of its annual revenue to fraud; $2.9 trillion globally
• Median loss due to occupational fraud is $160,000. Nearly one quarter of fraud losses total at least $1 million.
• Median ‘life’ of frauds - 18 months
• 80% of the frauds included in the ACFE survey involved personnel in the following departments: accounting, operations, sales, executive upper/management, customer service or purchasing.
• High level perpetrators cause the greatest damage to their organizations. Executive level frauds also take much longer to detect.
3. IMPACT OF FRAUD ON BUSINESS – STATISTICS

Primary Internal Control Weakness

- Lack of internal controls: 38%
- Lack of employee fraud education: 2%
- Lack of reporting mechanisms: 1%
- Lack of clear lines of authority: 2%
- Lack of employee fraud collusion: 1%
- Lack of control weaknesses, unreconciled accounts: 2%
- Lack of control weaknesses, payee on a check: 1%
- Lack of effective controls: 5%
- Poor tone at the top: 8%
- Lack of management review: 18%

Source: Association of Certified Fraud Examiners
2010 Report to the Nations

4. EXAMPLES OF FRAUD IN THE WORKPLACE

A. Funds Transfer Fraud Scam

- Location: USA
- Time period during which the loss occurred: 1 day
- Amount of loss: $50,000 to more than $1 million each transaction
- How loss was discovered: Upon receipt & review of bank statement

B. Employee dishonesty and vendor collusion

- Location: Singapore
- Time period during which the loss occurred: 5 years
- Amount of loss: 165 Checks, $6+ million
- How loss was discovered: An internal audit revealed control weaknesses, unreconciled accounts, and the employee named as payee on a check.

Source: Civil Division, US Department of Justice
4. EXAMPLES OF FRAUD IN THE WORKPLACE

C. Collection Agent Ponzi Scheme
   Location: USA
   Time period during which the loss occurred: 3 years
   Amount of loss: $80 Million
   How loss was discovered: Bankruptcy filing April 21, 2004

5. INVESTIGATING FIDELITY LOSSES

A. Objectives
   Primary
   • Determine facts and circumstances
   • Determine date of discovery
   • Determine who knew what and when
   • Quantification
   • Substantiation
   Secondary
   • Improve internal controls
   • Identify recovery and subrogation opportunities

5. INVESTIGATING FIDELITY LOSSES

B. Electronic Discovery Lifecycle - EDRM

Source: Socha Consulting and Gelbmann & Associates.
5. INVESTIGATING FIDELITY LOSSES

C. Accounting/Documentation Review

- Authenticity
- Completeness
- Relevance
- Corroboration/Consistency
- Accuracy

D. Interviews

- Planning and structure of interviews
- Timing, order and format of interviews depend on interview objectives
  - Informational/Fact-gathering
  - Corroborative/Confirmation
  - Admission-seeking
- Handling resistance
- Deception – verbal cues

E. Reporting

Considerations can include the following:

i. Oral vs. written
ii. Preparer
iii. Distribution of the report
iv. Facts, quantum and circumstances
5. INVESTIGATING FIDELITY LOSSES

F. Remediation

- Root cause analysis
- Remediation of internal controls
- Assess the need for revised policies and procedures
- Training
- Disciplinary action

6. FIDELITY INSURANCE COVERAGE AND SOLUTIONS

A. Fidelity Insurance - Preserving the Right to Make a Claim

1. Discovery and timely notification to the insurer
2. File the Proof of Loss on time or seek additional time from your Fidelity Insurer
3. The Policy requires the Insured do nothing to prejudice recovery, after discovery of loss

B. Claim Process

- The Proof of Loss = the definitive document of a fidelity bond claim
- The Insurer's review of the Proof of Loss
- Traditional vs. Fidelity Research & Investigative Settlement Clause (FRISC)
6. FIDELITY INSURANCE COVERAGE & SOLUTIONS

B. Claim Process (continued)

What must a Proof of Loss contain?

- A preamble stating that a claim for loss is being made under the appropriate policy number issued by the relevant underwriter
- A short history and description of the insured
- The employee(s) name and job description
- How and when was the loss discovered
- A narrative account of how the loss occurred
- Documents and exhibits in support of the claim must be attached and incorporated by reference

C. Fidelity Insurance Solutions

i. FRISC Process
   - The FRISC process - saves time and money
   - Joint investigation by the insured and the insurer
   - Facts and quantum of loss are final as to insured and insurer
   - 50% of the cost is covered by the insurer

Types of Loss and Documents/Information Reviewed by Insurers

i. Theft of cash - Insurers will review cash receipts, A/R aging reports, bank account statements, deposits, general ledger entries, etc.
ii. Employee collusion with vendor thefts - Insurers will review any amounts owed to the vendor, as a set-off, compare the cost of the goods or services before and after the fraud is discovered, obsolescence of products, etc.
iii. Theft of inventory - Insurers will review accuracy of inventory records, shrinkage, spoilage, damage, confirm if owned or on consignment, etc.
6. FIDELITY INSURANCE COVERAGE AND SOLUTIONS
C. Fidelity Insurance Solutions (continued)

ii. Fidelity Crime Insurance Solutions
   • Fidelity coverage available in the marketplace
   • Insurance considerations

7. CHANCES OF RECOVERY IN THE EVENT OF FRAUD

• Subrogation opportunities may exist:
  ➢ Perpetrator
  ➢ Third parties such as collusive vendors and collusive agents
  ➢ Others such as banks and former employers
• Statistics have indicated that very little is collected against the perpetrator.

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FRAUD RESOURCES

- BDO’s Ac’sense Focus on Fraud Series and other archived webinars: http://www.bdo.com/acsense/archive.aspx
- BDO’s Strengthening Corporate Governance Practice Aid: http://www.bdo.com/acsense/documents/practice/StrengtheningCorpGov2010-FINAL.pdf
- BDO Consulting: http://www.bdoconsulting.com/
- The Network’s 2011 Corporate Governance and Compliance Hotline Benchmarking Report
- Association of Certified Fraud Examiners 2010 Report to the Nations
- CAQ Anti-Fraud Initiative: http://thecaq.org/Anti-FraudInitiative/index.htm
- AICPA Fraud Prevention, Detection and Response: http://www.aicpa.org

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2. Group participants - After receipt and processing of submitted group sign-in sheets to cpdregistrar@bdo.com, group participants will be proctored into LearnLive and will be notified via e-mail when they can retrieve their certificates, following the steps above.

3. Sign-in sheets may be downloaded from the following: https://university.learnlive.com/content/public/1029/accessinstructions/CPE%20Attendance%20Sheet.doc

EVALUATION

- We continually try and improve upon our programming and appreciate constructive feedback.
- Following the program, we will be sending out a thank you e-mail that contains a link to a brief evaluation.
- Thank you in advance for your consideration!
That concludes today’s program.

THANK YOU FOR ATTENDING!

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