



# Ethical Decision Making

Fraud in a branch – a case study

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Wherever business takes you

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# Introductions

Peter Guo leads the Enterprise Risk Services practice in British Columbia. Based in our Vancouver office, Peter provides risk management, consulting and assurance services to private and public organizations.

With 25 years' of experience, as delivered assignments involving governance, risk management, people, systems and processes, as well as regulatory compliance, enterprise risk, internal audit, IT audit, business process controls, privacy, IT threat and risk assessments and third-party control reports (CSAE 3416, SSAE16).



# Introductions

Mike is a senior manager in the Forensic and Litigation Support Service line of MNP LLP. He is responsible for investigations across Canada. He works with First Nations, corporations, public sector organizations on employee misconduct, risk assessments, due diligence and harassment cases. Mike is designated as a Certified Forensic Investigator.

Mike has extensive knowledge and experience in the areas of harassment in the workplace, employee misconduct and the investigation of complex fraud schemes. He also helps organizations mitigate issues and strengthen anti-fraud and anti-harassment controls.



# Housekeeping

- Please make sure your mics are muted and your cameras are off.
- If you have any technical issues, please use the chat.
- We will have a Q&A period for the last 10 minutes of the presentation.
- I will try to address as many questions as possible during the Q&A period.
- If your question does not get addressed, my contact information will be provided at the end for a follow-up.
- We will be recording the presentation for future reference

# What are we going to review

- ✓ A case study from a steel organization as our example.
- ✓ What is ethical decision making and how to apply it to business decisions
- ✓ What policies and procedures assist with ethical decision making.
- ✓ Breakout groups to discuss how ethical decision making would have impacted a fraud scheme
- ✓ Anti-fraud controls and how ethical decision-making contributes to an ethical workplace

# Back to work



of FULL ARMS & HOGS

# ACFE Covid-19 Benchmarking Report

79% of survey participants observed an increase in fraud in the wake of Covid-19

There are increase in cyber fraud, payment fraud, employee embezzlement, fraud by vendors and unemployment fraud

48% increase for anti-fraud technology and 38% increase in fraud related consultants

# ACFE Report to Nations 2020: Canadian Edition

Median age for all  
fraudsters in  
the region was



45

## WHERE DID PERPETRATORS WORK WITHIN THEIR ORGANIZATIONS?

These were the five most common departments:



Executive/upper  
management  
19% OF CASES



Accounting  
16% OF CASES



Customer service  
13% OF CASES



Operations  
11% OF CASES



Sales  
10% OF CASES



# Protect the innocent

The case study we will present is based on a real case that was investigated by MNP in 2016. The names of the organization, location of the organization, the suspects, the suspect companies and vendors have been changed.

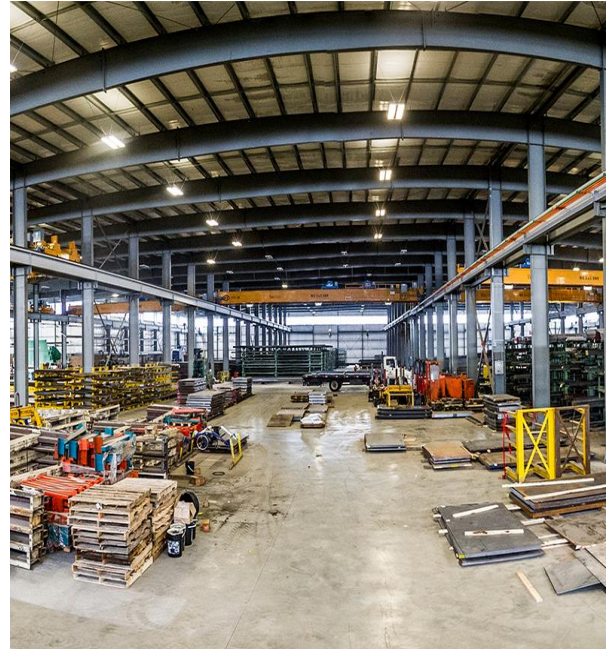
We have vetted photographs and information collected in order to show you what was discovered.

# The organization

Our organization, **Alpha Business Canada** (“ABC”) is a leading provider of steel, rebar, pipe and structural steel. It is headquartered in the Canadian mid-west and has over 50 locations across Canada. One of its branches had the least profitable margins of all its locations.

The branch in question had two sites; the main operations building and a storage yard. The storage yard was used to cut product for client requests. The main operations building acted as a warehouse and shipping location.

ABC imports steel from China and other locations, transports it from ports to its Branches which are responsible for client orders. ABC will provide custom cut steel products for building supplies, large and small vendors and very little “off the street” clients.



# Our protagonists

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Charlie – branch manager for over 20 years – he was responsible for the day-to-day operations, profitability, management of the branch

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Bob – operations manager who worked at another branch prior to arriving at the Nanaimo branch in 2014 – responsible for the inventory floor – cuts/picks/orders

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Raj – transportation manager – he was responsible for shipping and receiving, transportation contracts

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Susan – administrative assistant at the Branch – she is also Charlie's partner

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# Companies associated to our protagonists



**CBB Enterprises** – a vendor of ABC that purchased steel to sell to its vendors – owned by Charlie



**ABAB Renovations** – a vendor of ABC that did renovations to their buildings and outbuildings – owned by Raj



**BCR Logistics** – a trucking company that provided transport of ABC steel to vendors – owned by Charlie, Bob and Raj

# Breakout #1



# Breakout #1

- You own a successful steel company that manufactures end products used in large and small construction builds.
- You discover that your most productive manager at a remote branch has been taking scrap metal and bringing it to a scrap dealer for payment. He has received \$25,000 for the steel.
- He tells you that he is going through a divorce and needed the money. The scrap was being charged to clients anyway so there is no loss.
- This has been occurring for approximately 6 months.

# Group exercise

What do you do with the employee?

- Fire him.
  - Discipline him but keep him on as he is your best salesperson and manager.
  - Verbally warn him. Let him get back to making your money.
1. Rationalize/explain your decision.
  2. What do you have to consider in your decision?

# Responses

- Groups #1
- Groups #2
- Groups #3



# The case study response

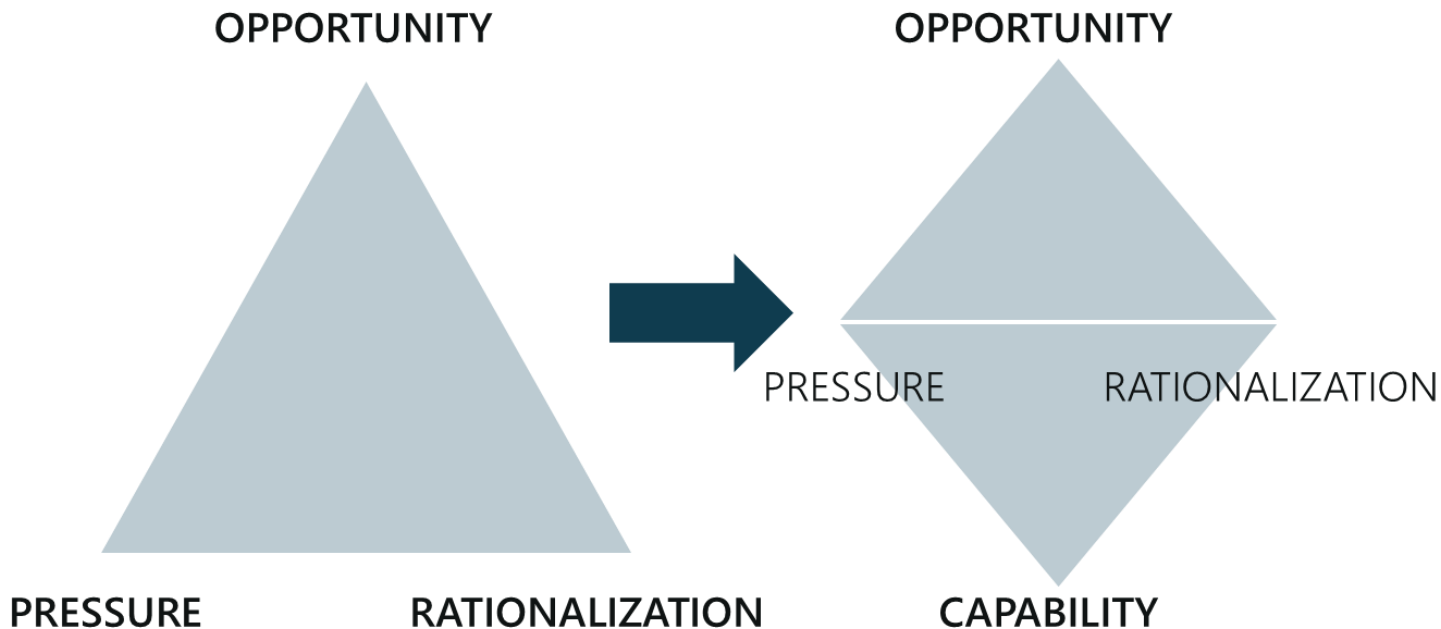


The owners believing that Charlie was an exceptional employee told him not to do it again and kept him in the position.

## The fallout:

- The insurance company advised that if Charlie were solely responsible for other frauds in the organization, the organization had accepted the risk of keeping him and therefore there would be no payout.
- The employees in the organization felt that Charlie was untouchable.
- The employees started acting unethically and there were widespread concerns that theft was occurring.

# Donald Cressey's Fraud "Triangle"



Source: ACFE

# We aren't starting from scratch

- Mission, vision and values
- Tone at the top
- Policies
- Procedures
- Culture within your organization.



# Tone at the top

This is the term that describes the ethical climate in the organization as established by the Board of Directors, Senior management, ownership and/or the audit committee. It helps prevent fraud and other unethical practices.

This guides the ethical decision making discussion.

# Ethical decision making



Acting ethically is the right thing to do. However, conforming to that high standard of conduct is not always clear cut. There are competing interests at play, whether profit margins, efficiencies, supply chain or simply staying afloat.



Ethical decision making is based on values such as trustworthiness, respect, responsibility and fairness.



It makes your company accountable and respected.

# Ethical decision making

Ethics is an integral part of management. Each business decision can break or respect rules and norms. They also have consequences and effects on employees, stakeholders, vendors, management and reputation.

An ethical framework is a set of questions that managers can use to get beyond moral intuition and clarify the features of the matter.

# Consequences



Losses to organization – result in law enforcement intervention



Reputational losses



Wasted time and resources



Recruiting issues



Low morale



Lawsuits

# What are we missing?

- Good internal controls – POLICIES and PROCEDURES
- Ethical environment – tone at the top and culture
- **Oversight** – hands out, fingers in.





# IDEA

**I**dentify the facts

**D**etermine relevant principles

**E**xplore options

**A**ct



# Ethical decision making

## Rationalize

We often rationalize our decision-making process by:

- “It’s the right thing to do”
- “Did you hear what happened to company X?”
- “We need to make sure that never happens again here?”

## Test your decision

In order to avoid rationalizations, put your decision-making process to the following three tests:

- Publicity test
- Reversibility test
- Generalization test

# Publicity test

## Reputation

Can you defend your choices if they were ever to be made public?

The prospect of having to face public disclosure helps to make people more critical of their assumptions and reasoning.



# Reversibility

- Can you defend the reasoning if you were on the losing end of your decision?
- This is critical in situations where employees are suspended or fired.
- It does not matter whether the person agrees with the decision, it is about whether they respect the reasons.



# Generalizability



- Can you be consistent regardless of whom is involved?
- Is it consistent to what the organization expects will occur?
- Is it industry standard/best practices?

# Industry standards/best practices

- Best practices are the working standards or **ethical guidelines** that provide the best course(s) of action in a given situation.
- Industry standards helps you benchmark what is important in your line of business and how you measure against your competition.

# Building the Ethical Framework



Questions in a framework may force one to think from other perspectives.




It assists moral intuition and confirms regulatory requirements



It should be in addition to business analysis and business requirements.


# Questions

 What do you know?

 Whom do I include in the decision-making process?

 What is expected of our employees?

 Is the decision defensible?

 What are the consequences of my action/inaction?



# Breakout #2



# How do know branch office is ethical?

Where teams are working remotely how do you know whether your operation is working ethically?

- Which mechanisms are available to you to get information from your employees/clients/vendors?
- What is the ethical framework for implementing mechanisms of these sorts?
  - What do you need to consider?
  - Publicity test/generalization test/reversibility test?

# Responses

- Groups #1
- Groups #2
- Groups #3

# Poll #1

- Whistleblower Hotlines

# Initial internal investigation

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An employee came forward indicating that the GM, Operations Manager, and Shipping Manager owned BCR Logistics – a shipping company.

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Another employee indicated that a large amount of steel was stolen from the storage yard.

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Another employee stated that company inventory and machinery had been sold and profited for by the GM.

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# Employee interviews

## Theft

An employee advised us that approximately two years before, he was told by Bob to load 70,000 and 90,000 pounds of steel on two shipping trucks without any paperwork – he did not have specific dates

A Pettibone truck was scrapped without paperwork – he did not have specific dates

The same employee indicated that Charlie had sold a Koike Plasma cutter belonging to ABC – the purchaser of the Plasma cutter stated he paid \$4,000 (\$2,400 in cash to Charlie) and received no receipts – he thought he was getting a good deal since the cutter was worth over \$5,000

# Employee interviews

Manipulation  
of invoices  
and records

Another employee was advised to move steel pieces outside the shipping yard for a client to pick up over a weekend

The employee checked the internal records and there was no invoice for this client

The materials were to be picked up by a transport company

The steel was "stolen" over the weekend

Charlie had taken the keys from one of the employees for the storage yard and had been doing "cuts" in the evening

# Steel moved outside the gates





# Employee interviews

- Two weeks earlier, Charlie's brother-in-law restacked a 40,000 lbs load of steel from a pile by the building – he was not an employee of the company
- Over a weekend, the alarm code was deactivated on Saturday and reactivated on Sunday – the alarm code is used by many employees
- The security camera footage was also lost due to a power outage – it is controlled by Charlie's laptop
- A review of Charlie's cell phone found the following date stamped photograph (this is not a company vehicle)

# Charlie's cell phone photos



# Culture

This was a relatively small operation with few people controlling the client – product process. The organization took the appropriate step to suspend the suspected employees, Bob, Charlie, Raj and Susan . This is critical for:

- Letting employees understand the culture change
- Employees feel more comfortable speaking out – others were worried about the subjects coming back to work
- Suspended employees still have an obligation to assist with investigations
- Dealing with vendors in small centres – suspiciousness – collusion



# Understanding the process



The hardest part of an internal investigation is understanding what the bad guy was thinking and how they managed to circumvent internal controls.



Collusion?

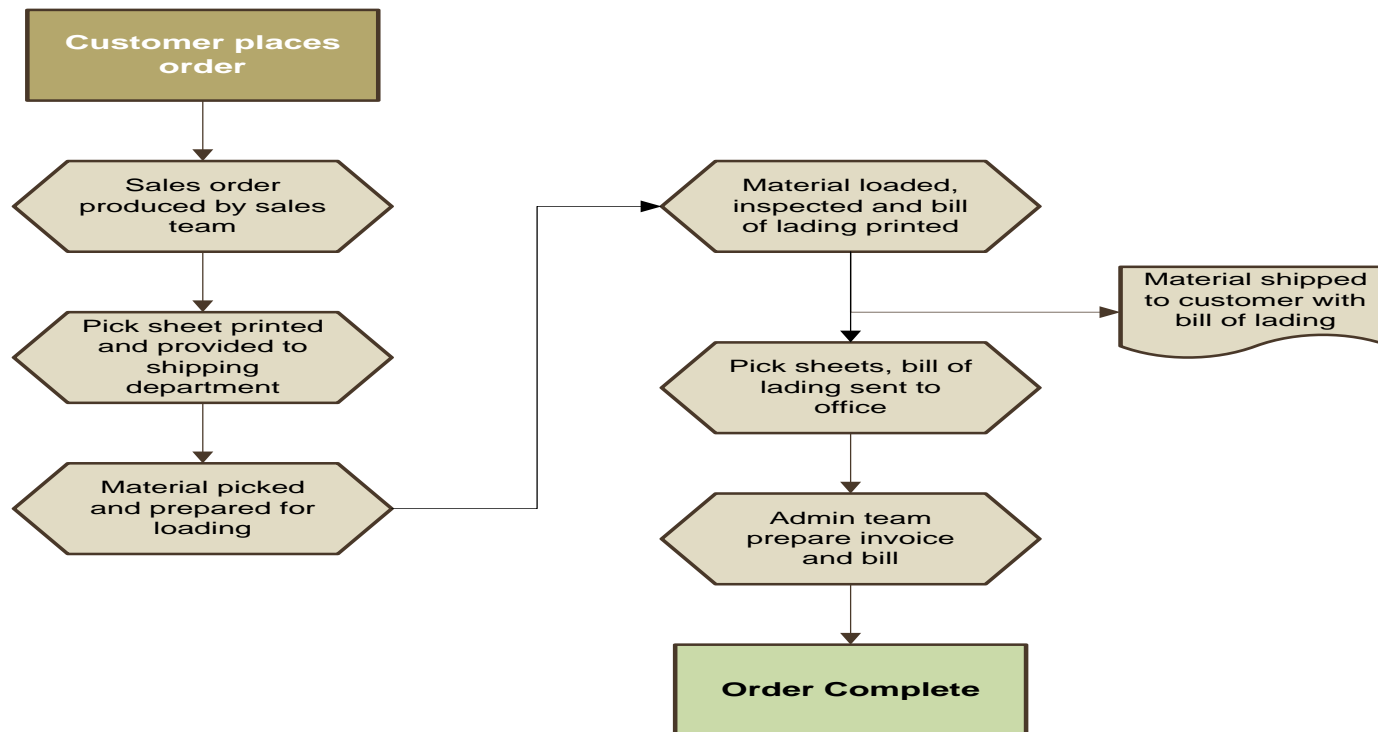


What access did management have?

# Pro tip #1

- **Risk assessments** and **controls review**
  - It is the identification of hazards which negatively impact an organization's ability to conduct business
  - An overall assessment of the organization's internal control system across each business area to ensure it is functioning as intended
- Recognize risks and address them accordingly – whether by policy, oversight, testing.

# The steel sales process



# Pro tip #2

Organizations are reluctant to reach out to vendors for assistance.

Organizations are reluctant to speak to their own staff confidentially.

Who know everything in your organization?

**Your admins!!**

# Breakout #3





# What policies do you need to have in place

In the scenario I set out, with the process for sending steel to clients using transportation companies – what policies would you need to have in place to ensure that this collusion did not occur?

- Pick one policy (and corresponding ethical action) that you think will ensure these actions don't occur?
  - Apply ethical decision-making principles.
  - Ethical action may be monitoring or meetings or procedures or inspections etc.

# Responses

- Groups #1
- Groups #2
- Groups #3

# Vendor Interviews

- We conducted 10 vendor interviews, including:
  - Automotive garage
  - Tire warehouse
  - Lumber company

# Automotive repair

- A vendor to ABC conducted repairs to the ABC vehicles on a regular basis. The owner of the garage told us that he conducted work on non-company vehicles and charged it to different vehicle numbers
- In an email provided by the Auto repair owner;  
*“Hello Bob, here is the repair order for Susan’s [sic] Honda. Please let me know what unit number you want us to charge it to.        Regards, James”*
- The owner provided invoices of \$5,672.46 for repairs related to non-ABC vehicles owned by Charlie and/or Bob

# Lumber company

- We identified over \$2,000 worth of invoices for lumber and treated decking from a vendor of ABC
- These photos were taken from Bob's phone along with text message;

*Bob: Use ISM Project account?*

*Big Shot: Sends picture of notes which reads "Lumber for the deck, 6x4 – 8 pcs 16ft long, 8x2 – 40 pcs, 20ft long, Decking 1x6 – 70 pcs 16ft long, 4x4 – 3 pcs 8ft long"*

*Big shot: Use po#102837*

*Big Shot: Send me a priced copy*



# Breakout #4



# Breakout #4

- We know that our staff are working from home unsupervised. How do we monitor the work that they do there?
- Using the approach of ethical decision making (generalization, reversibility and publicity) what controls can we implement to ensure staff work ethically while at home?

# Responses

- Groups #1
- Groups #2
- Groups #3



# Tech solutions

- Microsoft 365 – business edition allows users to review emails and do keyword searches. This may be critically important when an employee is alleged to have acted unethically or if an employee leaves an organization
- Organizations may have the capacity to monitor text message traffic of their staff as well.

# Data loggers

- There are organizations who have tried using data loggers to track the amount of time that employees work on their computers – what about tracking your fleet.
- Yes, it is legal
- What ethical effect will it have on your team?
- Will you be able to attract team members?



# Poll #2


- What does your company use for monitoring online activity of employees?


# Digital Forensics

- We conducted imaging and data carving of Bob's work phone
- We were unable to open Charlie's work phone
- We were able to retrieve Charlie's text messages from ABC's servers

# October between Charlie and Bob

Big Shot


 There is a quote in cash sales delta for Connor that I did last week... We need to create it into an order .. Please create and send me a copy to review with u 1:58 PM


 [Redacted] 2:20 PM

What was the PO on the cash sale?

October-18-14

Big Shot

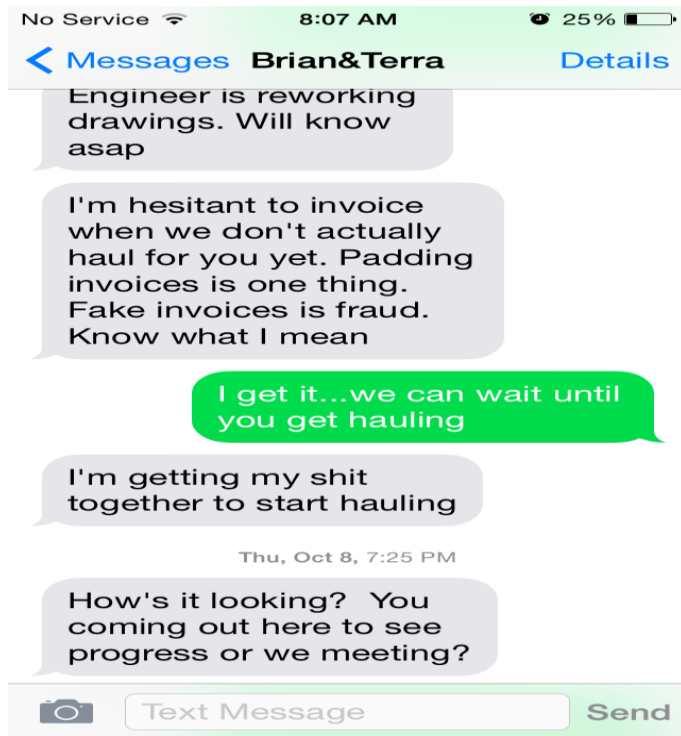
 It's under a quote .. Maybe get Connor to send u a copy 10:49 AM

 [Redacted] 10:50 AM

# Bob's photos – we are so proud of our toys



# Bob's text messages



# The money maker

- BCR Enterprises
  - Controlling shipping and receiving



# BCR Transport

- Charlie was the general manager and had control over sales records and the sales system
- Bob was the operations manager and was responsible for the floor – what was “picked” and what was loaded as per sales orders
- Raj was the transportation manager responsible for arranging all transport for sales orders
- Collusion!!!!



# BCR Logistics

- Raj owned one semi rig
- BCR Logistics was owned by Raj and Charlie
- BCR became the only vendor for the shipping of materials
- BCR invoiced ABC 154 times between January and May – of these invoices over 100 of them were undertaken by other third party companies according to shipping records – one company stated that “something fishy” was happening at ABC
- The third party companies charged ABC \$55/hour however BCR marked up the invoices to \$90/hour and pocketed the difference

# Spread the wealth - ABAB Enterprises

- ABAB Enterprises is a renovations company based in the area
- It is owned by Raj and his wife
- We were advised by an employee that we had to see it to believe how bad the renovations on the washroom were
- ABAB invoiced ABC over \$10,600 worth of work
- Raj in his interview stated that \$8,100 worth of the work was never started or completed – invoices were issued in advance and approved by Charlie
- Raj confirmed that he was double paid for work he did at another branch
- There were several cheques that Raj did not receive – they were cashed with his signature and Raj confirmed that these were not his signature
- A review of the cheque showed that the endorsement account number was the same as Charlies'

# Set up your own company – CBB Enterprises

- A search of Charlie's desk when he was suspended noted sales of materials by ABC to CBB Enterprises, a company owned by Charlie and Susan
- There were 5 invoices to CBB for steel purchased for resale – there is no reason that ABC would sell to CBB to sell to another vendor
- Charlie concealed the sale by inputting a lower price in the sales system than the invoice therefore realizing a personal profit of \$1,300 – the payment of the lower price has not been identified by accounts receivable
- There was a profit of over \$10,000 of sale of steel to CBB Enterprises

# The final tally

During the course of the investigation, we identified:

- More than \$846,000 worth of inventory which was unaccounted for
- More than \$90,000 worth of false or marked up invoices
- Thefts of tools, services, and product
- Undisclosed conflicts of interest
- Manipulation of sales system
- Long term theft and fraud

**Insurance – as of our latest information have not paid out the losses**

# Pro tip #3

Compliance is industry specific – there are industry standards and best practices.

Communication with your staff that you are watching and vigilant will deter unethical behaviour.

# Steps for ethics/compliance

- What are the steps in managing ethics and compliance?
  - Be proactive
  - Adopt and communicate ethics
  - Train your employees on compliance
  - Integrate hotlines into compliance program
  - Adopt risk based approach

# What can we do to prevent fraud?

- Segregation of duties
- Physical and IT security (access controls, cameras)
  - Assets/inventory
  - Information
    - Need to know
  - Cash/cash equivalents
- Approvals and supporting documents
- Training
- Procurement policies
  - Transparent, competitive
- Policies, including:
  - Code of Conduct
  - Acceptable use
  - Cash handling
  - Travel
  - Purchasing cards
  - Conflict of Interest
- Fraud risk assessment



# What can we do to detect fraud?

- Reconciliations
- Audits
  - Internal audits
  - External audits
- Surprise counts/audits
- Mandatory vacations
- Positive pay
- Right to audit clause in contracts
- Exception reporting
- Whistleblower hotline

# Conclusion

- As a business executive, business owner it is your responsibility to guide the organization
- Ethical decision-making is integral to the reputation and success of your company.
- Policies and procedures are the back-bone of ethics but re-enforcing these principles is critical to their effectiveness.



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Thank you for your time.  
**Are there any questions?**

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