

# Case Study - Internal Control Failures & Fraud



The Institute of  
**Internal Auditors**

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Atlanta Conference

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# | *Globex Corporation*

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# Outline: *Globex Corporation*

- Meet the Client
- The Payroll Process
- What Went Wrong?
- How Aprio Got Involved
- What did the Client Know?
- How did we Help? Our Findings
- Internal Control Failures
- Strengthening Internal Controls

# Meet the Client: *Globex Corporation*

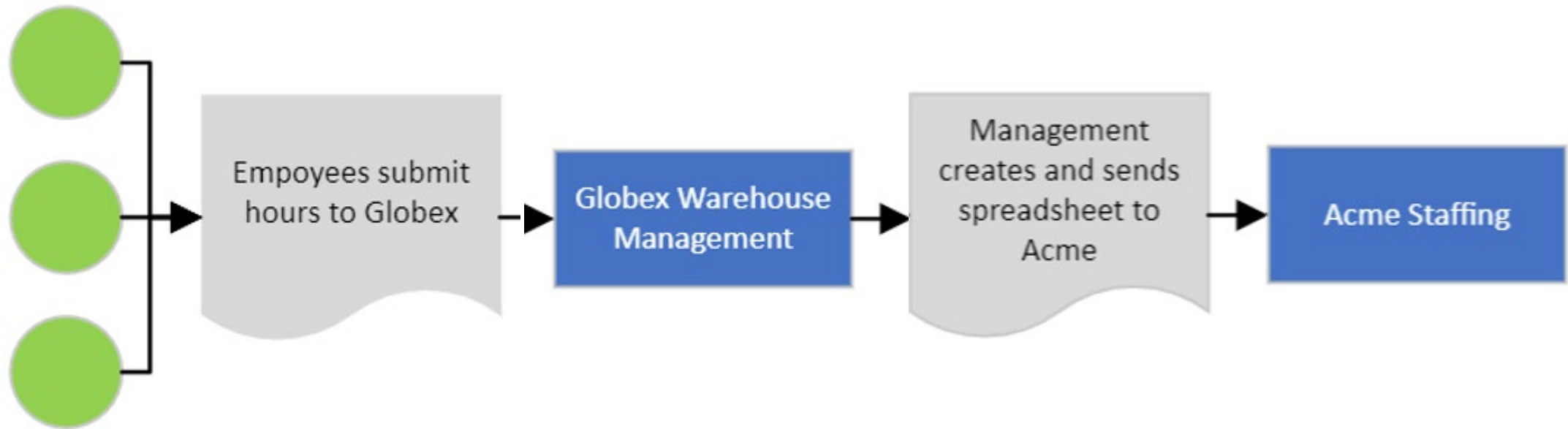
Globex Corporation (“Globex”) is a staffing firm that provides recruiting and labor management services.

- They assist in recruiting, training, and managing a workforce for different companies.
- Globex owns warehouses across the country with various product types and use third party vendors to staff the warehouses.

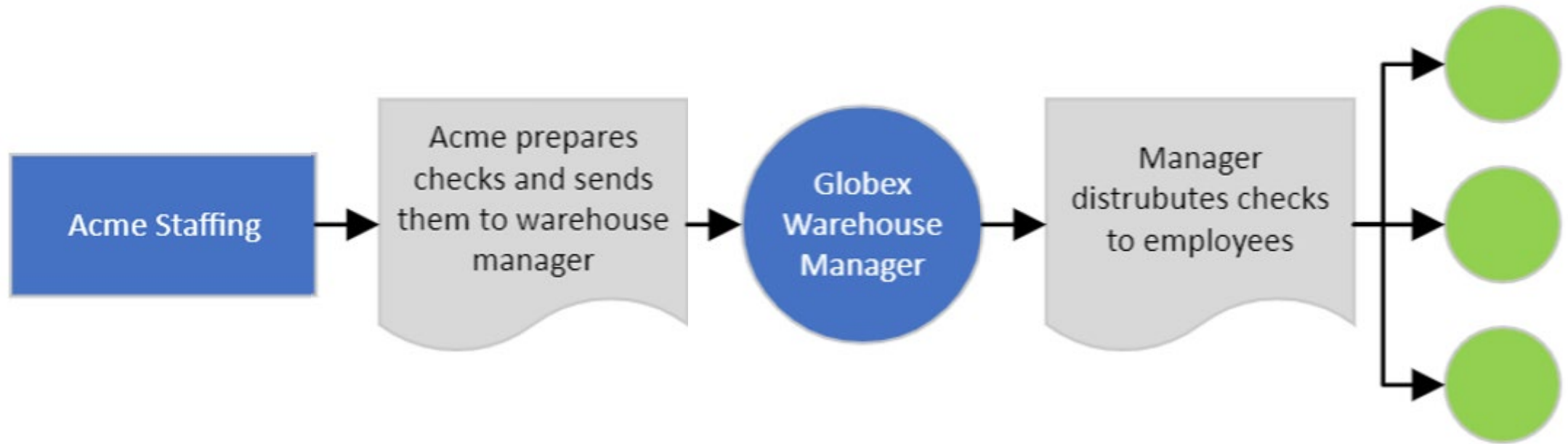
Globex contracts with several third-party vendors for their staffing needs, such as Acme Staffing.

- Acme Staffing posts the job openings, hires, and trains the staff that will ultimately be at Globex’s warehouse.
- This means that Acme Staffing is also responsible for payroll.

# The Payroll Process



# The Payroll Process



# The Payroll Process

Acme Staffing also prepares an invoice to send to Globex to pay for staffing on a weekly basis.

**Note:** Acme Staffing charges a 15% markup on each employees' total weekly fees for their staffing services

## Acme Staffing INVOICE

- Employee Name
- Hours Worked
- Rate
- Original Timesheet from Globex

# What Went Wrong?

## The Findings:

A Globex warehouse manager created two **ghost employees** that he utilized to defraud the company of over \$800,000.

## How did he get away with this?

- The warehouse manager told Acme Staffing he had two employees he wanted to hire for the warehouse and sent Acme Staffing the **Form I-9 Employment Eligibility Verification form**.
- Acme Staffing had built a relationship with the employee and did not object to this because at the end of the day, they are making money from additional employees. *(15% markup!)*



# What Went Wrong?

- Acme Staffing created checks on a weekly basis for these two ghost employees.
- The warehouse manager just kept and cashed these checks for himself (*remember – he is the one distributing the checks*).
- Globex was then paying the invoices that had these two ghost employees' names and timesheet information.

**This occurred from August 2016 – May 2023 (a total of approximately 7 years!!)**



# What did the Client Know?

The client found out about the ghost employee fraud scheme thanks to a **whistleblower** at the warehouse.

- This employee had worked at the warehouse for years and knew all the other employees.
- He noticed the ghost employees' names on a list and didn't recognize them.
- He then asked management about this, and he was not given a direct answer. He suspected something was up...

However, **YEARS** passed before the warehouse employee mustered up the courage to let the executive team know.

# What did the Client Know?

The executive team then launched an investigation.

- They reviewed old invoices and did indeed see the ghost employees' names.
- They also conducted a physical inspection of the warehouse and confirmed these ghost employees were not real.

Upon realizing they needed to find out who was behind this scheme and how extensive it was, **they called Aprio for an independent investigation.**

Shortly after Aprio started our investigation, **the warehouse manager confessed to the fraud scheme.**

# How did we Help? Our Findings:

1

*Interview Acme Staffing to understand their policies and procedures*

2

*Review ALL Acme Staffing weekly invoices to calculate the damage incurred by Globex*

3

*Prepare a report with our findings and damage calculation*

4

*Prepare an internal controls recommendation report*



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# Internal Control Failures?

## **Segregation of duties, segregation of duties, segregation of duties!**

- Employee hiring process
- Invoicing/Payments process

## **No departmental time sheet review/approval process**

- Warehouse manager seemed to be the only individual approving the warehouse employees' weekly timesheets.

## **Time clock was not properly being used/broken**

- The time clock the warehouse used was outdated and when there was suggestion of updating, warehouse management always pushed back.

# Strengthening Internal Controls

Preventative Controls	Detective Controls
<ul style="list-style-type: none"><li>• Employee Hiring Process<ul style="list-style-type: none"><li>- Documentation</li></ul></li><li>• Invoicing/Payment Process<ul style="list-style-type: none"><li>- Update time clock</li><li>- Exception Reporting</li><li>- Direct Deposits</li></ul></li><li>• Create a culture in which speaking up against fraud is encouraged</li></ul>	<ul style="list-style-type: none"><li>• Install recording equipment in various areas of the facility</li><li>• Invoices received should be emailed and received by warehouse manager and at least one other warehouse employee</li><li>• Random independent third-party audits of employees and contractors conducted on a periodic basis</li><li>• Provide fraud training to all employees on a periodic basis</li><li>• Perform an Inventory Audit</li><li>• Vendor Analysis<ul style="list-style-type: none"><li>- Contract Reviews</li><li>- Policy Reviews</li><li>- Fees Analysis</li></ul></li><li>• Conduct an Enterprise Risk Assessment</li></ul>

# | *CryptoCoin*

# Outline: *CryptoCoin*

- Meet the Client
- What was the Issue?
- How Aprio Got Involved
- How did we Help? Our Findings
- Internal Control Failures
- Questions

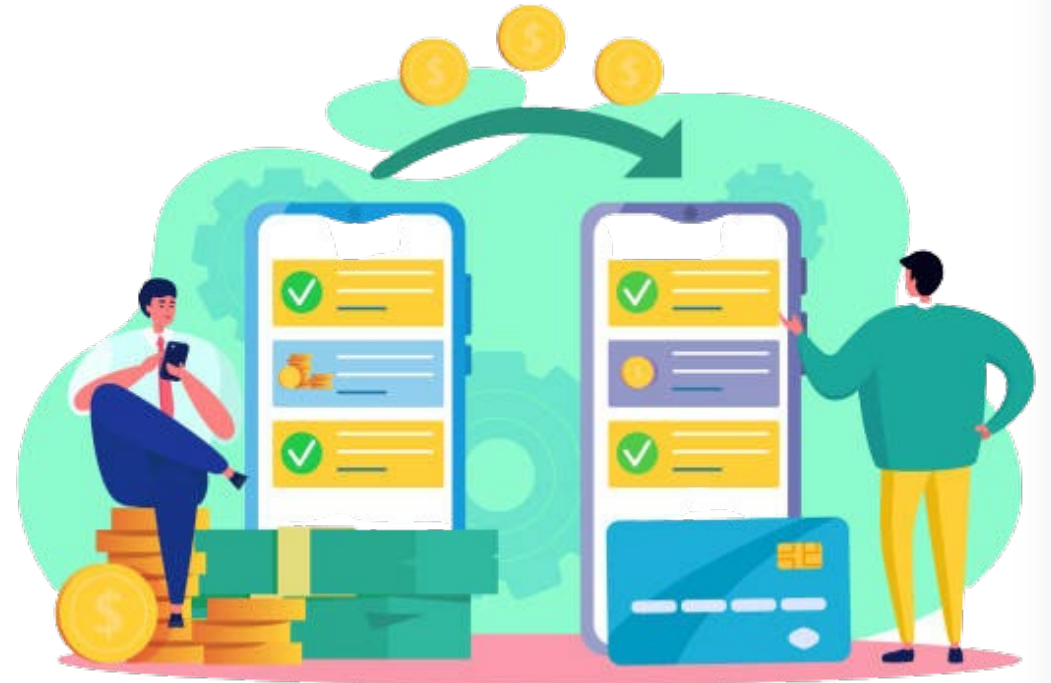


# Meet the Client: *CryptoCoin*

CryptoCoin is a startup company, intending to be a virtual currency exchange

- They planned to launch in the near future
- Registered with FinCEN as a Money Services Business (MSB)
  - MSB is defined as a business that transmits or converts money

CryptoCoin received money from investors and the founder of the company covered any additional funding needed.

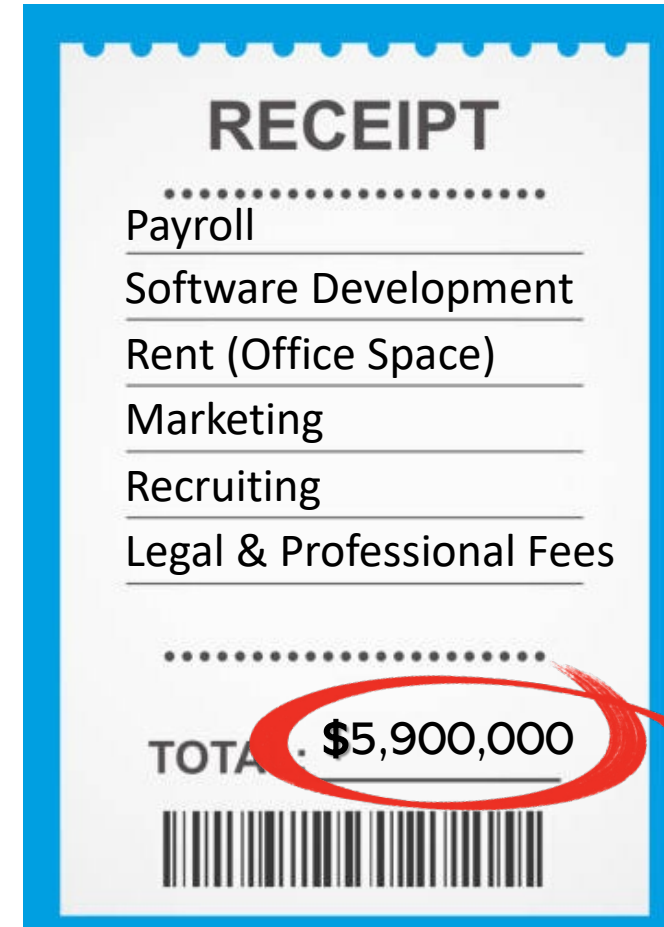


# What was the Issue?

- As a startup, CryptoCoin had no incoming revenue.
- However, they still had major expenses.

	2019	2020
Revenue	\$0	\$0
Expenses	\$1.4 Million	\$5.9 Million

- **CryptoCoin's CEO** needed to understand where exactly all this money was going.



# How Aprio Got Involved

- CryptoCoin's CEO called Aprio and asked us to conduct a "Financial Health Assessment"
- **In this review, Aprio would:**
  1. Review contracts and obligations related to vendors, contractors, and key employees
    - Key employees being employees who were building proprietary software programs
  2. Review employee expense reimbursement requests
  3. Review of Travel & Entertainment Policy

# How did we Help? Our Findings:

## 1. Vendor Review

Aprio specifically focused on ten vendors, contractors, and key employees and their related contracts.

**As part of our vendor review, we looked at:**

- Feasibility of contract performance and competition as it relates to financial performance
- Payments made pursuant to contracts, with particular reference to contract pricing and potential overpayments
- Any accrued or paid bonuses, incentives, or other forms of compensation for contractors

# How did we Help? Our Findings:

## Vendor Review Findings:

- 5 of the 10 vendors reviewed had payment and contract terms that were adequately met
- 5 of the 10 vendors reviewed were missing sufficient documentation
  - Aprio was able to see payments going to them in the general ledger, but there was little to no documentation regarding contract terms and specific deliverables
  - **This means CryptoCoin was unable to verify if a vendor was overpaid or when a contract was adequately met**

**Aprio recommendation: Implement a document storage system to retain all contracts and agreements, with a retention policy of no less than five years.**

# How did we Help? Our Findings:

## 2. Expense Reports Review

- Reviewed employee submitted expense reports to identify any instances of personal expenses that may have been submitted by employees, **with a particular focus on C-level employees.**
- Review if any deviations from accepted expense policies and procedures.

### Review Findings:

- Reviewed 155 expense reimbursement requests of certain top level employees.
- **Review identified numerous instances of potential over-abuse by one individual.** Including country club expenses, excessive meals and travel expenses.

# How did we Help? Our Findings:

## 3. Travel & Entertainment Policy Review

- Reviewed policy and provided guidance on best practices and/or suggestions to the policy language, as well as recommendations for additional policies

### Best Practices Guidance:

- General Office Meals
- Automobile Rentals
- Receipt Reimbursement Amounts (must have receipt if above a certain total)
- Improve documentation of exception approvals

### Aprio Recommendation:

**Create an additional policy for non-travel related work expenses, which was not covered in their current T&E Policy, such as...**

- Cell phone reimbursement
- Office equipment and supplies
- Team meals or gatherings
- Printing, presentation, or shipping expenses
- Continuing education reimbursement

# Internal Control Failures?

- CryptoCoin's main failure was **not properly documenting their agreements** with vendors and contractors
  - HALF of the ones reviewed had little to no documentation supporting what services were being provided and what the price was
- **Which can lead to:**
  - Overpayments
  - Services rendered not being as initially expected or discussed
  - Confusion and frustration by employees and vendors/contractors, especially if there is turnover of internal employees with the initial knowledge





| Questions?

# Meet Aprio's Forensics Team

**Our team includes specialized individuals that include the following certifications:**

- Certified Public Accountants (CPA),
- Certified Fraud Examiners (CFE),
- Accredited in Business Valuation (ABV),
- Certified in Financial Forensics (CFF),
- Certified Valuation Analyst (CVA),
- Certified Forensic Accountant (CRFAC),
- Certified Anti -Money Laundering Specialists (CAMS),
- Juris Doctorate (JD)

## Our Leadership Team



**Haley Beatty, CFE,  
CAMS**



**Stuart Rosenberg, CPA,  
CVA, CFF**



**William Foote, CPA, CVA,  
ABV, CFF, CFE**

# Thank you.



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