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Fraud and the Distracted Employee

Lori Haley / June 21, 2021



Our learning objectives for today's session are to:

- Understand the fraud landscape and risks to your business
- Discuss fraud triangle and underlying pressures
- Explain some real-life examples happening in this industry
- High level review of control environments
- Explore some practical steps you can take now to address some of these risks

Why?

Why are we talking about this today?

- **Knowledge is power.** False security that there are services/ people who have this covered for my business
- Likely not stuff you think about everyday - front end of the business often gets more attention
- Growth is more fun, has energy and top line drives the business
But...what if much of that hard earned top line does not make it to the bank???
- Retail automotive business is complicated - 5 or 6 businesses in one
 - ✓ Large COA makes it easier to hide things
 - ✓ Volume of transactions, cash flows, and schedules
 - ✓ Limited internal controls

Why?

Why are we talking about this today?

- Tight circle of employees and unbalanced trust can have big consequences
- >50% of dealers have been victims of employee embezzlement or theft or know of someone who has
- COVID year has created new and different challenges for businesses and individuals. Work from home considerations included.
- Tone at the top and your examples and influence drive culture

What is the landscape?

Family and Employees

Everyone always wants more...



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

What We Think of When We Hear Fraud?



What We Should Think Of

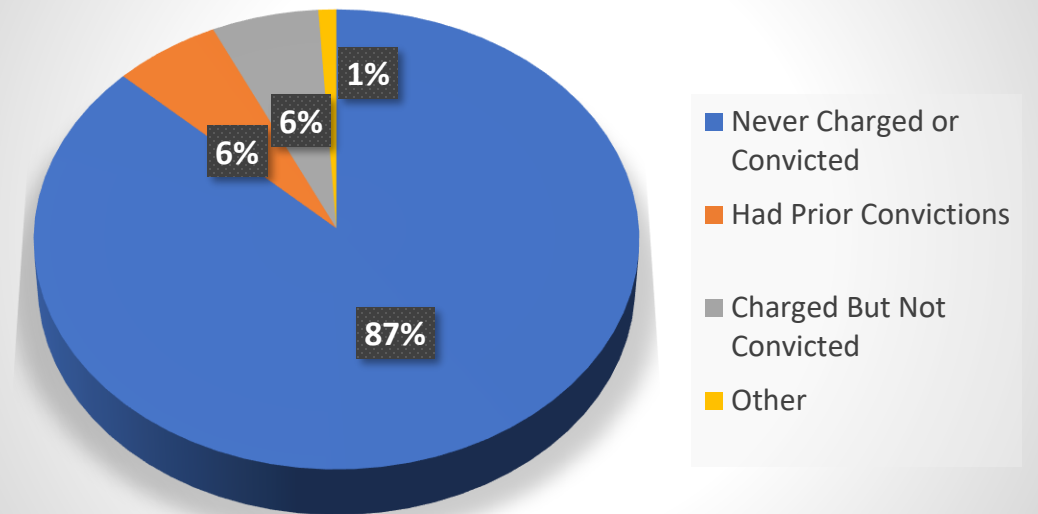


Perpetrator Profile

Behavioral Red Flags:

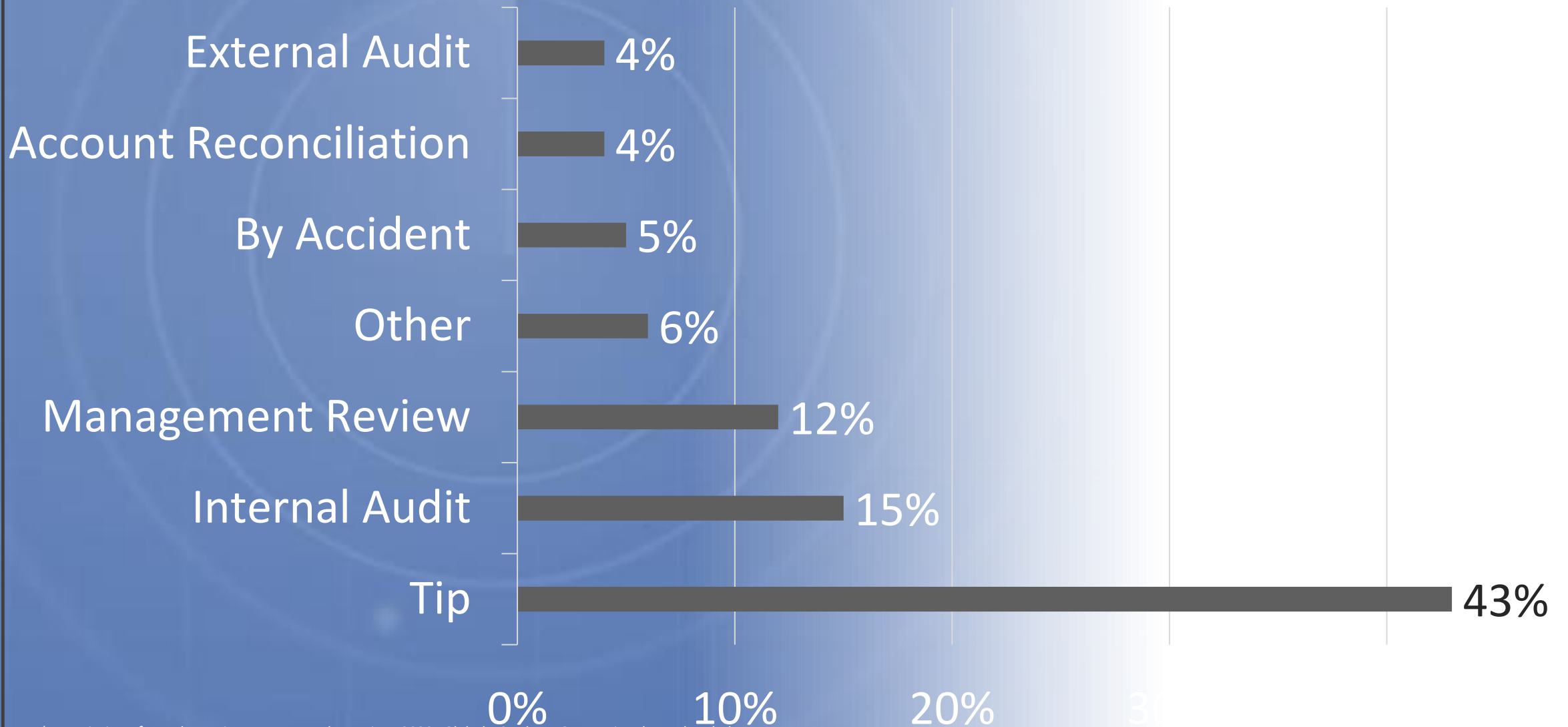
- Living beyond means
- Financial difficulties
- Wheeler-dealer attitude
- Unwilling to share duties
- Unusually close relationship with vendor
- Divorce or other family problems

Perpetrator's Criminal History



Source: ACFE

How is Fraud Detected?



* Association of Fraud Examiners Report to the Nations 2020 Global Study on Occupational Fraud and Abuse

Conflicting Points

**Inspect What You
Expect**

- 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**

**Employee Trust &
Empowerment**

Tone at the Top

“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



1. Personal Integrity



2. Intelligence



3. High Energy

Fraud Triangle and Real-Life Examples

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Cressey's Fraud Triangle

Perceived Opportunity

FRAUD

**Incentive /
Pressure**

Rationalization

AUDIT

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Possible underlying pressures

- Drug and alcohol abuse, mental health issues
 - Employee, spouse, dependent
- Loss of job with family member
- Gambling addictions
 - 5 out of 100 people have a gambling problem
- Elder care
 - 7 out of 10 people over 65 will need long-term care (LTC)
 - Costs can range from \$4,000 - \$7,000 per month

General Manager Fraud



- Many times the top day to day person – power of position
- Ownership entitlements
- Vendor relationships
- GM/GSM and gambling

Used Wholesale



- Collusion - Wholesale vendor relationship involving kickbacks
- Vehicles sold, titles delivered, floated the payment well after vehicle sold by wholesaler
- Floorplanning inventory for the wholesaler
- Sloppy on schedule review
- >\$5M loss when it all shook out

Vendor Fraud Case



- **Employee** printed unauthorized business checks from her employer and deposited them into personal and business accounts – over 2 years before detected
- 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**



Controller Fraud

- We owes and transfer to lien payoffs

Six figure loss – mortgage payments

- Intercompany

Multi store group

Management co. receivable

Non-scheduled account

Undetected for 4 years

loss is in multiple million \$

- Unauthorized wire transfers

Payroll Fraud Examples

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



Parts Fraud Examples

- Stealing Parts
- Cost Adjustments/DMS access
- Credit Memos
- Open Parts Tickets
- eBay

Internal Control Environment



Internal Controls Can Help You Prevent This...



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



Deter



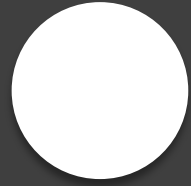
Detect



Prevent

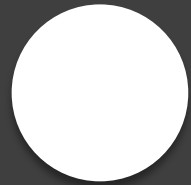
Three-Pronged
Approach:

Prevent, Detect & Deter



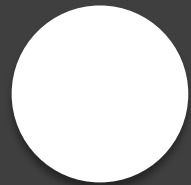
Prevent

Authorizations, Physical controls,
Seg of duties



Detect

Account reconciliations, Physical
inventory counts, Internal audits



Deter

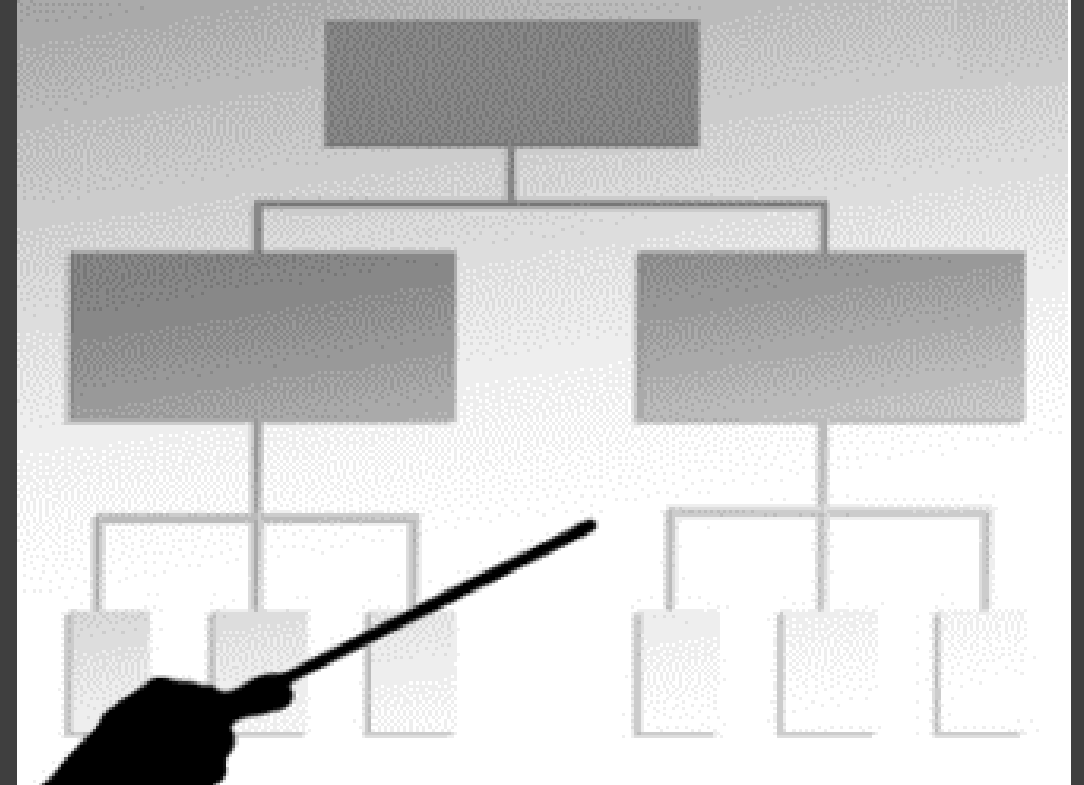
Job rotation, firewalls, alarm
systems

Three-Pronged
Approach:

Prevent, Detect & Deter

Segregation of Duties

- **Separate key functions –**
 - Authorization
 - Custody
 - Record keeping
- **Rotate functions, require mandatory vacations**
- ***Collusion is one of the most difficult forms of fraud to detect***



Components of Internal Control



What are your current processes?



What risks do those processes pose?



If issues are noted, how are those communicated and addressed?



What steps or controls are in place to mitigate those risks?



How does management ensure those steps to mitigate related risks are being performed?

Let's Turn to Positive Steps

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So...What can I do NOW?

- Talk about this with some regular cadence – make it part of your organization's DNA (management meetings, onboarding, employee manuals)
- Risk Assessment on your current control environment
- Positive pay with the bank
- Check your EFT and wire transfer authorization policies
- Rotate duties and cross train
- Ask questions, keep employees on their toes
- Hire right – background checks
- Pay fairly
- Follow through when you detect a problem, no double standards

INSPECT WHAT YOU EXPECT!

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Questions?

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