

THE FRAUD CLINIC

By Tim J. Leech, CA, MBA

Investigating Conflicts of Interest

Last month, I discussed how to perform a conflict of interest control audit. Now we will investigate procedures for handling a real or suspected conflict situation.

To start, let's assume that you receive an anonymous tip that a senior manager in your company is directing business to a company owned by his common-law wife. Your informant also claims that your organization is paying excessive amounts as a result of this conflict of interest. What should you do?

The first stage

Complete a discreet review of the situation to assess whether the allegation appears true. This preliminary investigation involves ideally as few people as possible. Attempt to get answers to the following questions:

- Is the manager actually directing business to the company identified in the allegation?
- What is the dollar magnitude of payments to the company?
- How long has the manager been directing business to this company?
- Who are the registered officers and directors of the company named by the informant? (This is usually obtained from a corporate registry search.)
- If not already known, what is the correct name of the employee's common-law spouse? (This can be determined by a variety of means, including checking life insurance beneficiaries listed on the suspect manager's group insurance forms or a title search of the individual's residence.)

- Does it look like standard tendering requirements have been met for the purchases made from the potentially non-arms length company or does the process appear to have been subverted?
- What type of goods or services are being purchased? Does it appear that the goods or services were actually provided or received?
- Has the informant provided all the information that might be of value?
- Does the contract with the company in question provide for the right to audit?

If these preliminary steps are not familiar to you, or you are uncomfortable completing them, you should ask yourself one fundamental question before starting even a preliminary review.

"If you are not properly trained in investigative techniques, you could alert the guilty parties, who might then destroy valuable information"

Am I qualified?

If you are not trained in investigative

techniques, you could cause more harm than help: an innocent person's reputation could be damaged; you could alert the guilty parties who might destroy valuable information; you could miss key indicators and conclude nothing is wrong when, in fact, a significant problem exists; you could employ procedures that have the potential to damage your case and right to recovery; and you could get yourself and/or your company into a lawsuit. If you conclude that you are not adequately trained, you should consider engaging the services of an outside expert to provide specific advice to you on how to proceed.

If preliminary work suggests that a serious problem does exist, you should immediately involve legal counsel if you have not done so already; next, notify your fidelity insurer. These precautionary steps should be taken to protect your recovery position in the event that your detailed investigation reveals material losses.

If you have identified a problem, and decided to involve forensic assistance in the detailed investigation phase, the fees may be covered by your fidelity insurance if the case involves a breach of trust or fraud on the part of your staff. Again, legal advice should be obtained on this point.

The skills required to conduct this type of investigation include evidence collection and retention, interviewing skills, investigative procedures, financial analysis skills, data collection and manipulation, a basic knowledge of civil and criminal law, and many other specialized skills. Further, it's not just a case of what gets done. Equally important is how each aspect is carried out.

I believe that all large internal audit shops should have at least one individual trained in these skills. The certified fraud examiner program offered in the United States specializes in formal fraud investigation training. News of the introduction of the program was carried in this newsletter a year ago. If you missed it, information can be obtained from the National Association of Certified Fraud Examiners in Austin, Texas, at (512) 478-9070. A small number of Canadians have qualified as certified fraud

examiners (CFE), including myself and this newsletter's editor, John Sayers. I understand that the association will soon be actively promoting the program in Canada.

If you have a security function fully experienced with commercial fraud cases, they may be able to work with the internal audit department to investigate the initial allegation and assist with the more detailed loss investigation. Review of aspects such as specialized financial information and data storage/analysis can provide opportunities for valuable evidence that may otherwise be overlooked.

No matter what route you choose, the rights of the accused must be respected. On the other hand, ignoring the allegation or performing a superficial or amateurish investigation of conflict of interest allegations can be extremely dangerous to the health of your organization.

In next month's column I will discuss some analytical techniques that can be used to diagnose dangerous conflict of interest situations. Until then, good health to you and your organization.

At the time this article was written in 1990 Tim Leech was Managing Director of NCM Control & Security Services Limited, the Canadian subsidiary of an international consulting firm based in London, England. Tim Leech is now Principal Consultant and Chief Methodology Officer at Paisley Consulting, a world leader in business accountability software solutions. He can be reached by phone at 905 823 5518 or by email at tim.leech@paisleyconsulting.com