

FERRETING
OUT

FRAUD

THE DOW CHEMICAL COMPANY'S SUCCESS STORY

BY PAUL ZIKMUND

You've seen the three-paragraph blurb in the back pages of your newspaper: *Executive Prosecuted for Defrauding Company*. While most employees are honest, fraud remains a fact of doing business that not only impacts the bottom line but, if left unchecked, can damage employee morale. The question for The Dow Chemical Company is: How does a global corporation serving customers in 170 countries confront this sensitive problem consistently and cost effectively? Quite well, actually. For every \$1 we spend on investigating fraud, we recover nearly \$4, which is very high by industry standards. And with more than 50,000 employees, Dow's loss per employee is far below the industry average of \$9 per employee per day.

To tackle fraud head on, we created Fraud Investigative Services (FIS) in 1998. Originally named Asset Protection and Recovery, FIS formalized the process for addressing fraud and reinforced Dow's high level of ethical business behavior. In the past, Human Resources, individual supervisors, or outside consultants investigated fraudulent activities. Although we continue to coordinate our activities with other functions such as Legal, Security, Controllers, Human Resources, Information Systems, and Senior Management, FIS centralizes the process of fraud investigation in an objective and independent subfunction within Dow.

That's not to say fraud is running rampant here. Most of our employees are honest, and because FIS represents Dow's intolerance for illegal behavior of any kind, employees are more aware of our adherence to the highest levels of business ethics and strong corporate governance.

I'll take you on the job with FIS, look at the red flags of three types of internal fraud, walk you through the steps of an investigation, and explain the challenges that a global company faces as well as the value our department adds.

ON THE JOB AT FIS

In a specialized function such as ours, every day is different as we try to fulfill FIS's mission, which reads: *"The mission of Fraud Investigative Services is to deter and prevent incidents of fraud and financial abuse through detection, investigation, and education."* The following areas are investigated: kickbacks, including receipt of excessive gifts or cash; expense report fraud; loss or theft of intellectual property; conflicts of interest resulting in actual or exposure to financial loss for Dow; vendor fraud; embezzlement; check fraud; payroll fraud; bribery and corruption; fraudulent financial reporting; improper pricing activity; and improper spending of company money.

We're responsible for all steps in the process from receipt of an allegation of fraud through submitting the investigative report to the Employee Review Board, which determines the level of employee discipline. A decision to pursue criminal prosecution of a case, through turning the case material over to local law enforcement, is made by a small cross-functional team. We complete most reviews within one or two months, although more complicated cases can take more than a year to resolve.

CHALLENGES OF FRAUD INVESTIGATION IN A GLOBAL COMPANY

One of the greatest challenges facing FIS is that Dow is spread around the world. From our base in Midland, Mich., there are obvious logistical barriers to conducting an investigation 10,000 miles away. But it's even more complicated than that. Countries have different legal requirements regarding fraud and privacy of employees, and information accessible in one country may not be legally obtained in another. Language barriers can also cause misunderstandings and complicate an investigation. To top off the challenges, cultural differences may call into question what even constitutes fraud. For instance, some vendors in certain regions feel they must offer money or gratuities to get business, which may be a common practice in certain areas but is a clear violation of Dow's business rules.

Dow addresses these issues by relying on local management to collect evidence and conduct preliminary interviews until an FIS team member or an exter-

nal consultant can arrive. Especially with allegations outside the U.S., it can be more cost effective to use a consultant in our network for a relatively low-dollar-value investigation.

One key problem with investigating fraud outside North America is that FIS lacks visibility in some countries. For this reason, we recently hired a full-

time investigator in Hong Kong, and in just over one month he investigated more cases than FIS had opened in Asia the entire previous year. The combination of increased visibility, the internal marketing of our services, and our direct efforts with Dow business leaders and the Asia/Pacific Ethics and Compliance team have made all the difference in Asia. Given this success, we may consider adding a full-time investigator in both Latin America and Europe at some point in the future.

As director of FIS, I report directly to Dow's corporate auditor. We have four full-time staff members, all directly involved in investigations. Their backgrounds vary and include accounting, business administration, criminal justice, law, and certified fraud examination. Much of our time is spent analyzing data and documents, interviewing employees, documenting findings, and traveling approximately 30% to 40% of the time in North America and overseas.

The majority of our work is internal to Dow, but there are times when we have to interview a vendor and, even more rarely, a customer. These types of meetings are particularly sensitive, but we must conduct them. To carry out all investigations quickly, confidentially, and with minimal disruption to operations, FIS frequently engages and supervises external investigative consultants, a particularly helpful approach in cases far from the organization's headquarters in Midland, Mich.

FIGHTING FRAUD THROUGH EDUCATION AND COMMUNICATION

FIS investigates approximately 100 allegations a year, which isn't a large number for a company with more than 50,000 employees. We'd be naïve, though, to believe that all fraud is reported. If we want to identify current fraud and abuse and deter further activities, it's imperative that we make people aware of FIS and help them detect "red flags" of possible wrongdoing. Yet our two main obstacles in ferreting out fraud are to help people observe those red flags of fraud and, once they observe something, to report it. The goal isn't to have a Big Brother system in place but to use two powerful weapons for fighting fraud—education and communication—so employees can use common sense in spotting and reporting fraud.

To educate employees, we conduct our outreach through a combination of promotion at the FIS website on Dow's intranet, through internally distributed news stories, and via seminars our staff conducts around the world. Members of my staff and I give presentations to site leaders, Human Resources, and employees at Dow plants around the globe. And since we know that employees are more likely to report suspected fraud to their managers than to us, we focus on teaching management so that they in turn can educate their people.

Our key messages for managers are:

- ◆ Maintain an increased awareness of fraud and abuse.
- ◆ Ask questions when suspicious activity occurs.
- ◆ Report suspicious activities in a timely fashion.
- ◆ Document and record your activities.

- ◆ Control rumors.
- ◆ Continue support of the process through awareness and education of your teams.
- ◆ Remember that senior management sets the tone of integrity for the entire organization.

For employees who want to report fraud anonymously rather than go to their manager, we helped establish the global Dow EthicsLine (a telephone hotline accessible from anywhere in the world), a P.O. box, and an online e-mail reporting mechanism.

FRAUD WARNING SIGNS

The most common types of fraud allegations we review involve expense report fraud, kickback schemes, and embezzlement. To determine if these types of fraud exist we look for the following warning signs.

Expense Report Fraud

- ◆ Excessive amount of expenses without receipts or supporting documentation.
- ◆ Sequential numbering of invoices.
- ◆ Handwritten receipts from restaurants.
- ◆ Purchases from retail establishments including toy stores, malls, and sporting goods stores.
- ◆ Excessive cash advances taken against the company credit card.
- ◆ Continuously late expense report account reconciliation.
- ◆ Numerous expenses under the minimal amount requiring a receipt, which is usually less than \$25.

Kickback Schemes

- ◆ Vendor contracts awarded without bids.
- ◆ Repeated use of the same vendor.
- ◆ Excessive complaints about product quality.
- ◆ Invoiced prices that differ from prices listed in the contract.
- ◆ Employee living beyond his/her means.
- ◆ Employee not taking any vacation time.
- ◆ Sequential or photocopied invoices.
- ◆ Vendor address listed as a P.O. box.
- ◆ Continual instances of short shipments or missing inventory.

Embezzlement

- ◆ Discrepancies between invoice amount and amount paid.
- ◆ Invoices for unusual items with no supporting documentation.
- ◆ Unexplainable cost variances between budget and

actual amounts.

- ◆ Unbalanced financial ratios (could indicate overbilling or product diversion).
- ◆ Verification of employee Social Security numbers.
- ◆ Inflated salaries or travel expenses.
- ◆ Duplicate employee addresses (may indicate ghost employees).

THE INVESTIGATIVE PROCESS

FIS conducts each investigation within clearly defined guidelines that govern how the group operates. We use a four-step process that includes receipt of allegation, preliminary review, investigation, and final disposition.

First, employees, vendors, and customers send us allegations. Dow maintains an Alertline that offers employees and external parties the ability to anonymously report fraud allegations if they so choose. Once the allegation is received, it's documented in the FIS database, which stores all information on each case, and the case is assigned to an investigator within the group.

Next, the investigator conducts a preliminary review to obtain reasonable suspicion that a fraud occurred. For example, when we look into an allegation that a vendor compensated an employee for offering them a contract, we take the following steps:

- ◆ Determine if the vendor provides services to the company.
- ◆ Review amounts paid to the vendor for the previous few years.
- ◆ Ensure that the person named in the allegation is employed and is in a position to award or influence the decision to award contracts to vendors.

If the results of the preliminary review don't support the allegation, the investigative process ends. For example, if the employee isn't in a position to award contracts or is unable to exert influence during the selection process, we deem the allegation to be false. On the other hand, the discovery of information that positively supports the allegation will justify conducting an investigation.

Then the actual investigation takes place, which requires the most time and resources because it includes employee interviews, data analyses, document reviews, and evidence collection. We conduct each investigation with the mind-set that all cases will be brought to court, so we carry out the investigation with strict adherence to laws, regulations, employee privacy rights, evidence collection standards, and civil guidelines. Although only a small percentage of cases are litigated, each file is completed in a professional manner.

The investigator will often rely on Management, Human Resources, and Legal to assist during the fact-gathering stage. They provide counsel and guidance pertaining to employee labor laws, diversity issues, previous history of improper conduct, and additional factors relating to the allegations. The investigator conducts employee interviews and is always assisted by a Human Resources representative who serves as an advocate for the investigative process and ensures that the employee and company rights aren't violated.

Then we summarize the investigation results in a final report that we distribute to key individuals prior to the final disposition step. Certain personnel involved during the investigation review the report and determine the appropriate action to resolve the issue. In most cases, appropriate action includes:

- ◆ Employee disciplinary action.
- ◆ Implementation of internal controls to prevent future occurrences.
- ◆ Revisions to existing vendor contracts.

CREATING VALUE FOR DOW

Because Dow is a company where most people don't tolerate fraud and abuse, FIS delivers both perceived—and real—value. People want to help us, and the response to our outreach has been outstanding. An internal organization such as ours contributes value through pride of ownership, relationship building, and an intimate understanding of the company culture. Although financial information regarding the value FIS captures for Dow is confidential, as I mentioned earlier, we currently recover nearly \$4 for every \$1 invested in our services. This puts us at the high end of the industry average.

Today, slightly more than half of U.S. corporations don't have an internal organization comparable to FIS. Instead, they use outside consultants exclusively, but that trend is reversing. Although we find it worthwhile to use consultants on specific projects, outsourcing our function completely could cost Dow as much as five times more than our current costs.

For all these reasons, plus the additional confidentiality that an internal investigative team offers, Dow has found FIS to be a good investment in maintaining high standards of integrity and compliance throughout our global corporation. ■

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