


Annual Convention
October 3, 2011




Detecting & Preventing Fraud in Your Lodging Establishment

*Establish policies and procedures to avoid
fraud and a guide to the fraud investigation
process*

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MODERATOR

Roy Cupler, CPA

Business Assurance Partner,

Chair of Moss Adams' Hospitality and Gaming Services Group

- The majority of Roy's professional experience has been providing services to hospitality organizations. This experience has permitted him to emphasize achieving a practical, clear understanding of audit results to assist clients in improving their operations.



PANELIST

Howard Jacobs

Principal, Continuum Hotels

- As Principal of Continuum Hotels, Howard leads the companies consulting, project management and development assignments as strategic partners on retail, hospitality and customer focused organizations.
- Howard also serves as the companies lead (SME) Subject Matter Expert on branded and independent boutique hotels by providing asset management consulting, project management and comprehensive direction on acquisitions, repositioning of under-perform hotel and restaurant companies, mediation on hospitality disputes and feasibility studies.



PANELIST

Lori Richardson, CPA

Business Assurance Senior Manager

- Lori has over 13 years experience in public accounting, including five years with a Big Four accounting firm. Her responsibilities include engagement management, planning, organizing, and supervising a wide variety of audit engagements; internal controls operational assessments; and financial statement analysis.
- Lori's experience includes audit and review engagements for various clients, which include Tribal casinos, hotels, restaurants, and other hospitality organizations. In addition, she has performed reviews of internal controls for operational efficiency and training programs.



PANELIST

Gina St. George, CPA, CFE

Consulting Manager

- Gina is a consulting manager with over twenty years of hospitality and gaming industry experience, including four years as the controller for a Tribal gaming facility, five years as a financial and compliance auditor, and over ten years in restaurant management.
- Gina is also a Certified Fraud Examiner and conducts forensic investigations and assists clients with strengthening internal controls to prevent and detect fraud. She is a member of the Association of Certified Fraud Examiners, Institute of Internal Auditors, and the Hospitality and Technology Professionals with a current appointment to the PCI Compliance Task Force.



AGENDA

- **Fraud Facts**
- **Fraud Detection: Red Flags**
- **Hotel Fraud Schemes**
- **Fraud Prevention**
- **Fraud Response Plan**



FRAUD SIMPLY DEFINED

- An **intentional act**
- Something intended to **deceive**
- **Deliberate** trickery intended to gain an advantage.



FALLACIES

- We analyze our statements monthly and would notice if anyone was stealing.
- We're a small property so we don't have to worry about that sort of thing.
- We know all of our employees very well. We trust them.

FACTS

- **Businesses lose 20% of every dollar to employee theft**
- American Society of Employers
- **75% of employees steal from work and most do so repeatedly**
- US Chamber of Commerce
- **Employee dishonesty costs American businesses in excess of \$50 billion annually**
- U.S. Dept of Commerce

WHO DETECTS FRAUD?

Initial Detection of Occupational Frauds



Tips: **40.2%** - **46.2%**

Internal Controls: **26.7%** - **23.3%**

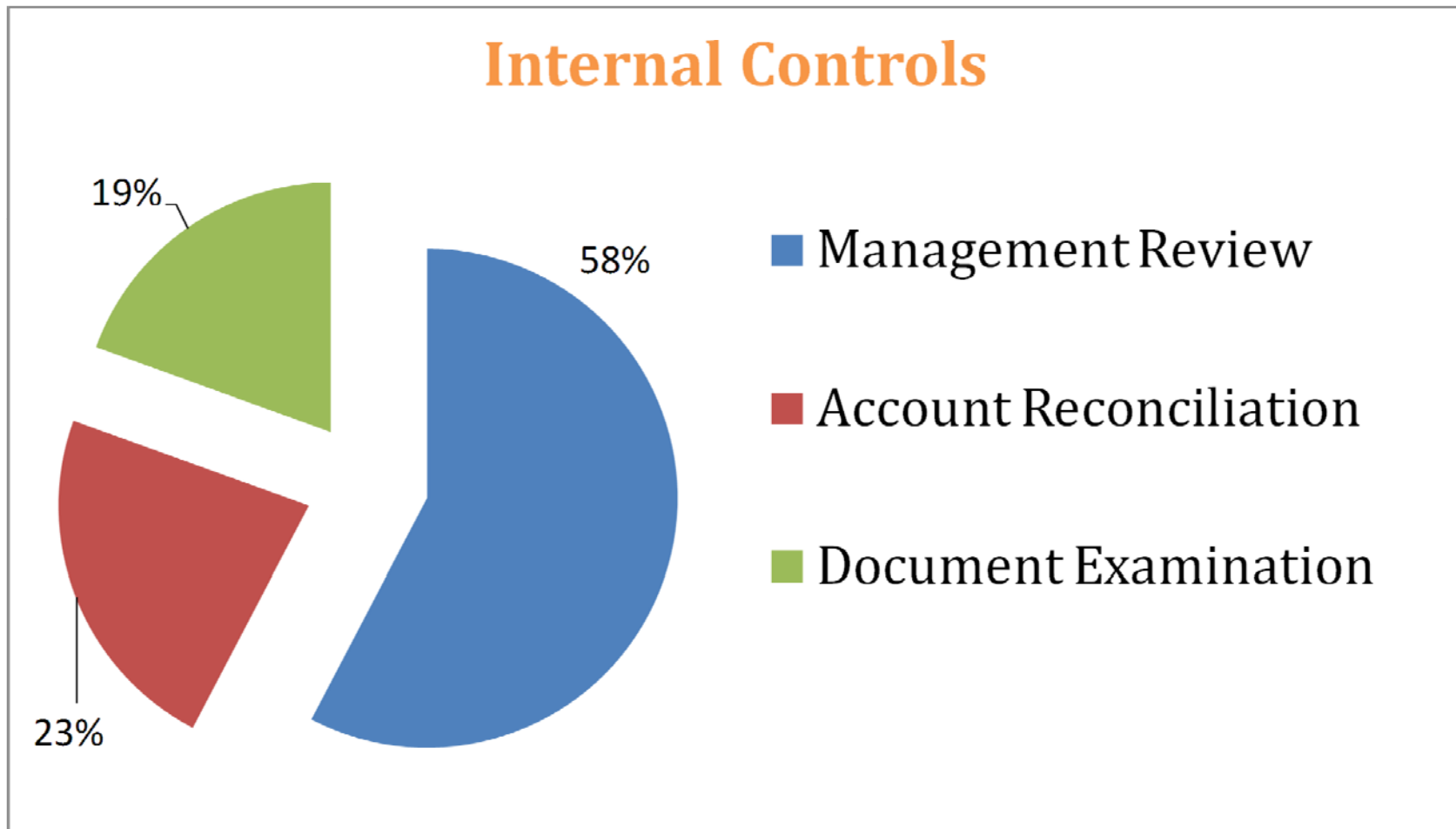
Internal Audit: **13.9%** - **19.4%**

By Accident: **8.3%** - **20.0%**

External Audit: **4.6%** - **9.1%**

ACFE Report to the Nation (**2010** vs. **2008**)

WHO DETECTS FRAUD?



WHO COMMITS FRAUD?

External Risks – Guests

Target Areas by Guests

- Payment with fraudulent credit cards
 - Watch for walk-in, same day or faxed authorizations
- Collusion with employees or vendors
 - Example: Multiple Stolen Laptops
- False insurance claims
 - Vehicles, staged accidents, food poisoning claims

WHO COMMITS FRAUD?

Internal Risks – Employees

Motive – Current economic crisis

- Cut-back in hours
- Minimal raises
- Decreased tips (Food & Beverage)
- Family employment status (Spouse, Children, Parents)

Opportunity – Nature of the Hotel Industry

- Cash banks
- Inventory
- Poor property leadership
- Lax controls, procedures and internal/external audits
- False wage & hour violation claims

Rationalization - “*I need it more than they do*”

2010 ACFE REPORT TO THE NATION

Occupational Fraud Schemes – US – 1,021 Cases		
Scheme	Number of Cases	Percent of Cases
<i>Billing</i>	282	27.6%
<i>Corruption</i>	224	21.9%
Check Tampering	173	16.9%
Skimming	165	16.2%
Non-Cash	160	15.7%
Expense Reimbursements	154	15.1%
Cash on Hand	117	11.5%
Payroll	108	10.6%
Cash Larceny	98	9.6%
<i>Financial Statement Fraud</i>	44	4.3%
Register Disbursements	25	2.4%

FRAUD DETECTION: RED FLAGS



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OPERATIONAL RED FLAGS

High Risk Hotels



- Lack of Policies and Procedures/Internal Controls
- Override of Existing Controls
- No Management Review Function
- Poor Tone at the Top
- Lack of Independent Checks/Audits – Internal & External
- Lack of Clear Lines of Authority
- Lack of Employee Fraud Education
- Lack of Fraud Reporting Mechanism

LIFESTYLE CHANGES



Internal Risks – Employees

- Job dissatisfaction
- No longer requests or volunteers for extra shifts
- Prefers to work slower shifts
- Driving a newer car
- Moved to bigger house
- Talks about shopping or vacations
- Wearing nice jewelry
- Pays for co-worker expenses after hours

FRAUD DETECTION

Top Behavioral Red Flags - Employees

Living Beyond Means:	43%	-	39%
Financial Difficulties:	36%	-	34%
Control Issues/Unwillingness to Share Duties:	23%	-	19%
Unusually Close to Customers or Vendors:	22%	-	15%
Divorce/Family Problems:	18%	-	17%

ACFE Report to the Nation (**2010** vs. **2008**)



EMPLOYEE FRAUD PROFILE

Bev Harris, in ‘How to Embezzle a Fortune,’ says that fraudsters and embezzlers are the nicest people in the world:

- Wide-eyed mothers of preschoolers
- Your best friend
- CPAs with impeccable resumes
- People who profess deep religious commitments
- Loyal business managers who arrive early, stay late and never take vacation
- Family members

HOTEL FRAUD SCHEMES

In Search of Red Flags



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HOTEL FRAUD SCHEMES

- **Data Breach – *External and Internal Threats***
- **Credit Card Refund Scheme**
- **Receiving Scheme**
- **Billing Scheme**
- **Point-of-sale Schemes**
- **Payroll Scheme**
- **Marketing Scheme**
- **Revenue Skimming Scheme**
- **Vendor Scheme including cash and non-cash kickbacks**

DATA BREACHES



September 8, 2010	HEI Hospitality (HEI Hotels and Resorts) Norwalk, Connecticut	BSR	HACK	3,400
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A vulnerability was discovered in the information systems of multiple hotels. Customers who used credit cards between March 25 and April 17 of 2010 may have had their credit card information exposed.

Information

Source:
Databreaches.net

records from this breach used in our total: 3,400

November 20, 2010	Desert Rose Resort Las Vegas, Nevada	BSR	HA
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Some guests and employees were affected by a breach or breaches that occurred between June 2010 and October 2010. Credit and debit card information was stolen and misused. The method that criminals used to access the information was not disclosed.

UPDATE (11/30/10): Other hotels owned by Desert's parent company Shell Vacation Resorts may have been affected.

UPDATE (12/22/10): A notice on Shell's website states that the breach occurred because of a malicious software infection. It was determined that the management system software program of Shell Vacation properties was infected with the malware.

Information

August 13, 2010	Doherty Hotel and Convention Center Clare, Michigan	BSR	HACK	150
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Over 150 credit cards used at the Hotel's restaurant were later fraudulently charged. It is believed that the Hotel's database was illegally accessed.

Information
Source:
DataLoss DB

records from this breach used in our total: 150

<http://www.privacyrights.org/data-breach>

DATA BREACHES



External Threats

- Implement Strong Network Security Controls
 - SSL encryption on web engines
 - Insurance coverage on 3rd party reservation systems

Internal Threat from Employees

- Limit access to full credit card numbers
 - ✓ Credits processed without full credit card number
 - ✓ Credit card numbers are masked in PMS system
 - ✓ Credit card numbers are masked in database

CREDIT CARD REFUNDS

➤ **Billing Department of Hotel**

- Guest deposits \$50 to \$100 for hotel incidentals
- Guest checks out without a refund for unused amount
- Guest credit remains dormant for a few weeks
- Billing employee refunds balance to personal credit card

➤ **Management Oversight**

- Trace all refunds to original payment
- Separate initiation from refund processing
- Require supervisory level approval for all refunds
- Conduct daily or random audits of all paid outs or refunds



RECEIVING SCHEME



➤ **Restaurant Procurement**

- Chef orders items for restaurant
- Chef inspects and signs for items on invoice
- Driver diverts some items to second restaurant
- Second restaurant owned by Chef
- Chef's brother accepted delivery at second restaurant

➤ **Plausible Explanations**

- Food and other costs are high due to economy/inflation
- We can't charge more on the menu due to economy/inflation
- Our turnover in the kitchen is high so there is a lot of waste

RECEIVING SCHEME

➤ Restaurant Procurement

- Poor delivery controls at receiving dock
 - ✓ *Items are rarely counted or weighed*
- Driver shorts delivery and/or pulls items from boxes
- Dock employee signs for full delivery order
- Driver sells stolen items to “cash only” restaurants



Vendor Schemes including cash and non-cash kick-backs:
Insist upon regular rebidding of providers with RFP
process

BILLING SCHEME

➤ Payments to Fictitious Vendors

- Fictitious vendor set up in system
- Fictitious invoice “scanned and uploaded” to accounts payable
- Accounts payable does not pay from original invoice
- Check sent to P.O. Box, employee or accomplice address

➤ Plausible Explanations

- We checked around and could not find a better price
- We forgot to budget for expenses related to seasonal employees
- That was a repair because of the wind storm that happened last month



Substantial increase in fraudulent billings for domain name registration, federal government travel programs and trademarks

POINT-OF-SALE SCHEMES

➤ Cash from employee bank

- Discounts or Coupons
- Credit card receipt alteration
- Not ringing up cash sales



➤ Management Oversight & Reconciliations

- Surprise count of cashier banks
- Eliminate multiple employees sharing the same bank
- Management presence
- Detailed review of documentation
- Cashier analysis: Cash, Comp, Discount, Coupon, Credit Card % to Revenue

PAYROLL SCHEME



- **Payment to Ghost Employee**
 - Fictitious or past employee in payroll system
 - Timecard submitted by manager or inputted by payroll
 - Payroll check processed
 - Payroll clerk or manager cashes check

- **Plausible Explanation**
 - We are trying not to layoff any employees – just cut back their hours



MARKETING SCHEME

➤ Rewards Scheme

- Employee joins “Open Table”
- Fraudulent reservations entered
- Employee confirms own fraudulent reservations
- Reward points for each confirmed reservation
- Points redeemed for gift certificates

➤ Plausible Explanations

- Business has been picking up lately
- Our team is great about letting people know about “Open Table”
- We hear that more and more people are using the internet to look for somewhere to eat



REVENUE SKIMMING SCHEME

➤ Kickback or skimming cash payments

- Front desk clerk adjusts room rate
- Front desk clerk deletes cash folio
- Cash room revenue pocketed by front desk clerk

➤ Plausible Explanations

- There was a posting error to the room revenue by market segment

Keys issued to rooms on “out of order” status for single night, cash paying, or late arriving guests

FRAUD PREVENTION



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FRAUD PREVENTION

- **Tone at the Top**
- **Day-to-day Employee Oversight**
- **Compliance with Internal Controls**
- **Zero Tolerance for Fraud**



FRAUD PREVENTION

➤ **Tone at the Top**

➤ **Executive Management & Leadership Team**

- Foundation for a fraud prevention culture
- Personal accountability and responsibility – Walk the Talk
- Push anti-fraud message down to lowest level employee
- **Maintain employee morale**

“Workers who are well treated, respected and adequately compensated are much less likely to commit fraud”.

Hollinger and Clark, Research Study



FRAUD PREVENTION

➤ **Day-to-day Employee Oversight**

➤ **Managers & Supervisors**

- Role models in employee development
- Oversight over day-to-day employee procedures
- Ensure adequate training for employees
- Regularly communicate issues and company policies
- Improve internal controls
- Detect early warning signs of fraud: *Red Flags*
- Understand how to report fraud



FRAUD PREVENTION

➤ **Compliance with Internal Controls**

- Recognize & investigate unusual financial relationships
- Recognize & investigate unusual employee behavior
- Discuss unusual items with employees
- Trust but verify plausible explanations
- Alert Management to control weaknesses

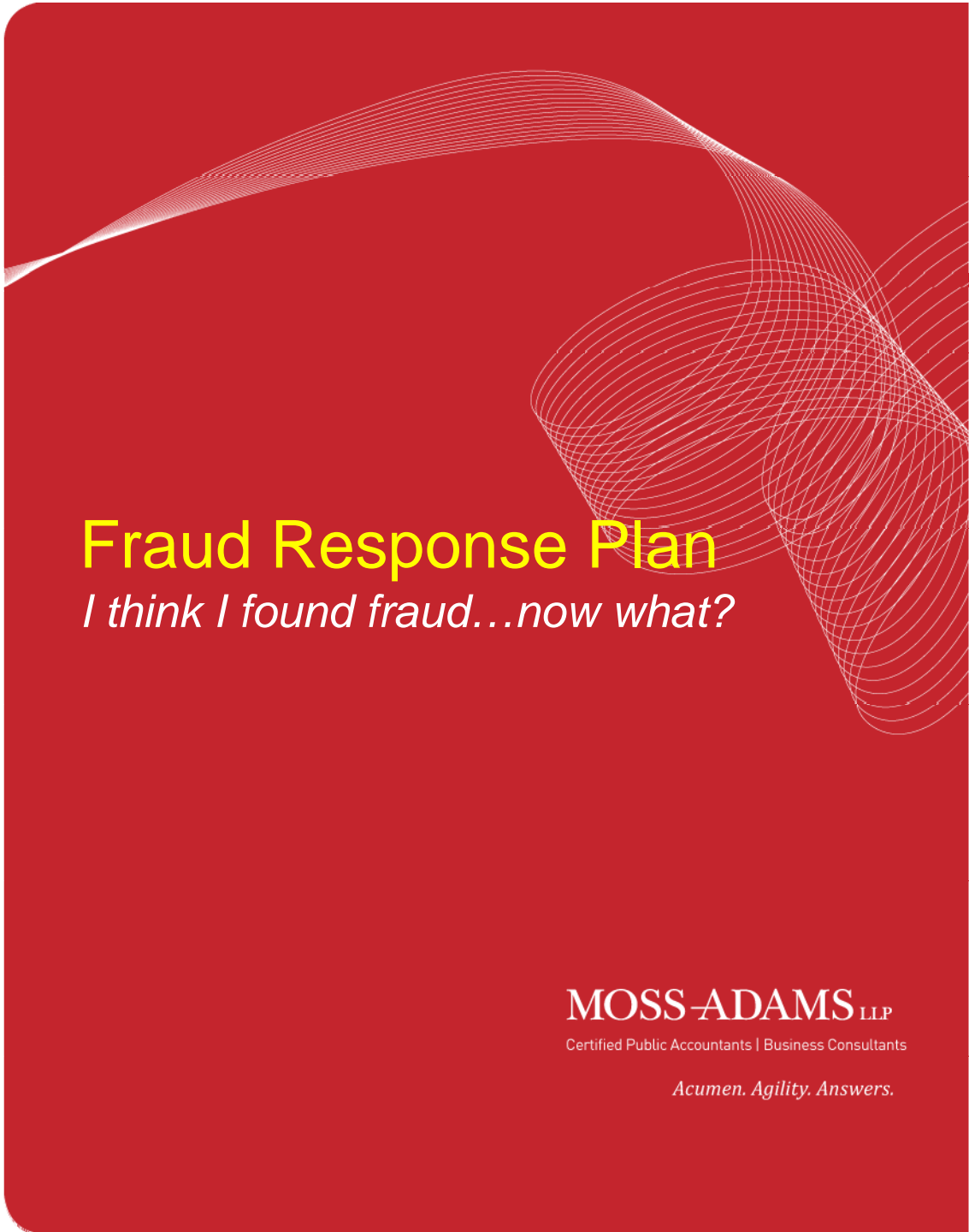
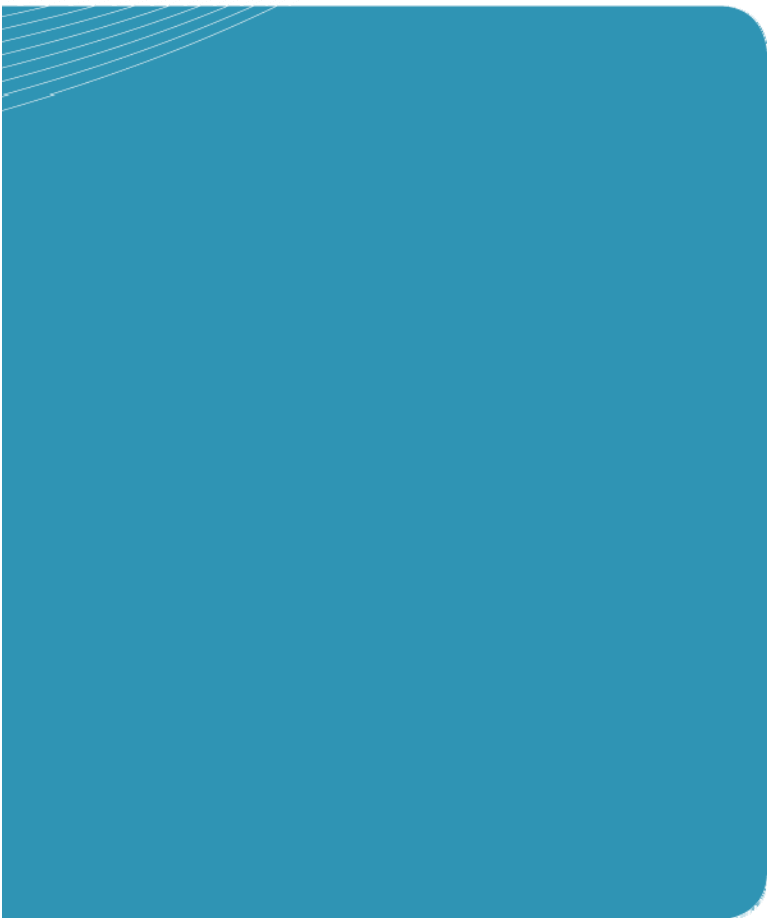
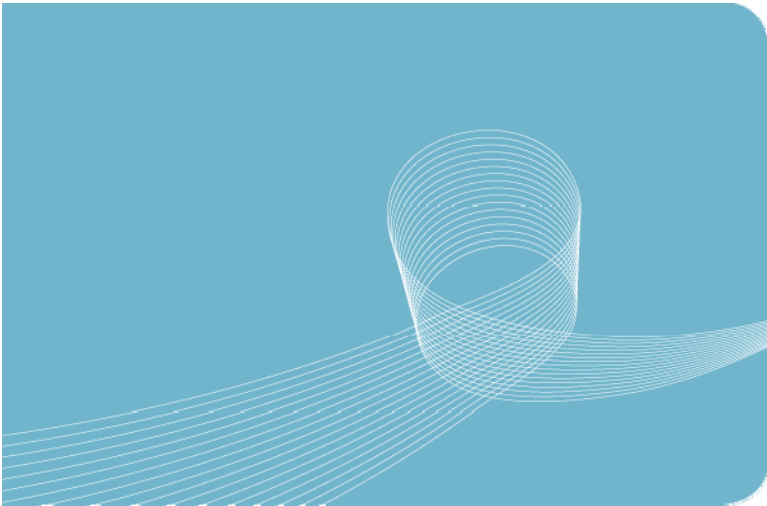
FRAUD PREVENTION

➤ Zero Tolerance for Fraud

➤ Human Resources

- Provide anonymous communication tools for employees to report tips
- Establish protocol for investigation – *“Innocent until proven guilty”*
- Establish appropriate consequences for fraudulent acts
- Apply consequences consistently

Without consequences.....an organization has no control.



Fraud Response Plan

I think I found fraud...now what?

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AGENDA

- **Clarify Fraudulent Acts**
- **Launch the Investigation**
- **Gather Evidence**
- **Interviewing Techniques**
- **After the Fraud.....**



DEFINITIONS

➤ Fraud

An intentional or deliberate act to deprive another of property by guile, deception or other unfair means

➤ Waste

➤ Abuse of Power

➤ Policy and/or Procedure Violation



LAUNCH THE INVESTIGATION

➤ Don't Delay

- ✓ Prevent additional losses
- ✓ Mitigate damage to reputation
 - Employees
 - Customers
- ✓ Planned response to act quickly
- ✓ Maintain an on-going relationship with local law enforcement

IMMEDIATE CONCERNS

➤ Financial Threat

- ✓ Access to cash or cash equivalents (Surveillance)
- ✓ Access to bank accounts – EFT & checks
- ✓ Access to credit cards and credit card numbers

➤ Loss of Evidence

- ✓ Secure physical access to records
- ✓ Access codes, locks, combinations changed
- ✓ Lock out network access (VPN, email, “cloud accounts”)
- ✓ Secure computer



IMMEDIATE CONCERNS

Current Employee – *Avoid immediate termination*

➤ **Coordinate with Human Resources**

- ✓ Administrative leave pending investigation
- ✓ Additional information needed i.e. surveillance footage

➤ **Develop strategies to obtain confession**

- ✓ Inquiries prior to employment termination
 - Information gathering interview
 - Admission seeking interview



FRAUD RESPONSE TEAM

Who is the “Fraud Czar” at your property?



FRAUD RESPONSE TEAM

- General Manager
- Human Resource Manager
- Controller/Finance Director
- Internal Auditors
- Department Managers



GATHER PRELIMINARY INFORMATION

- Review preliminary information
 - Review accounting documents
 - Clearly document via written statements
 - Review surveillance footage
 - Admit no liability on guest fraud issues
 - Support guest concerns without restitution
- Determine if there is a basis to launch an investigation i.e. *Predication*
- Request additional data for evaluation, if needed

DEFINITION OF *PREDICATION*

pred·i·ca·tion

noun \pre-də-kā-shən\
/

- ❖ the logical affirmation of something about another

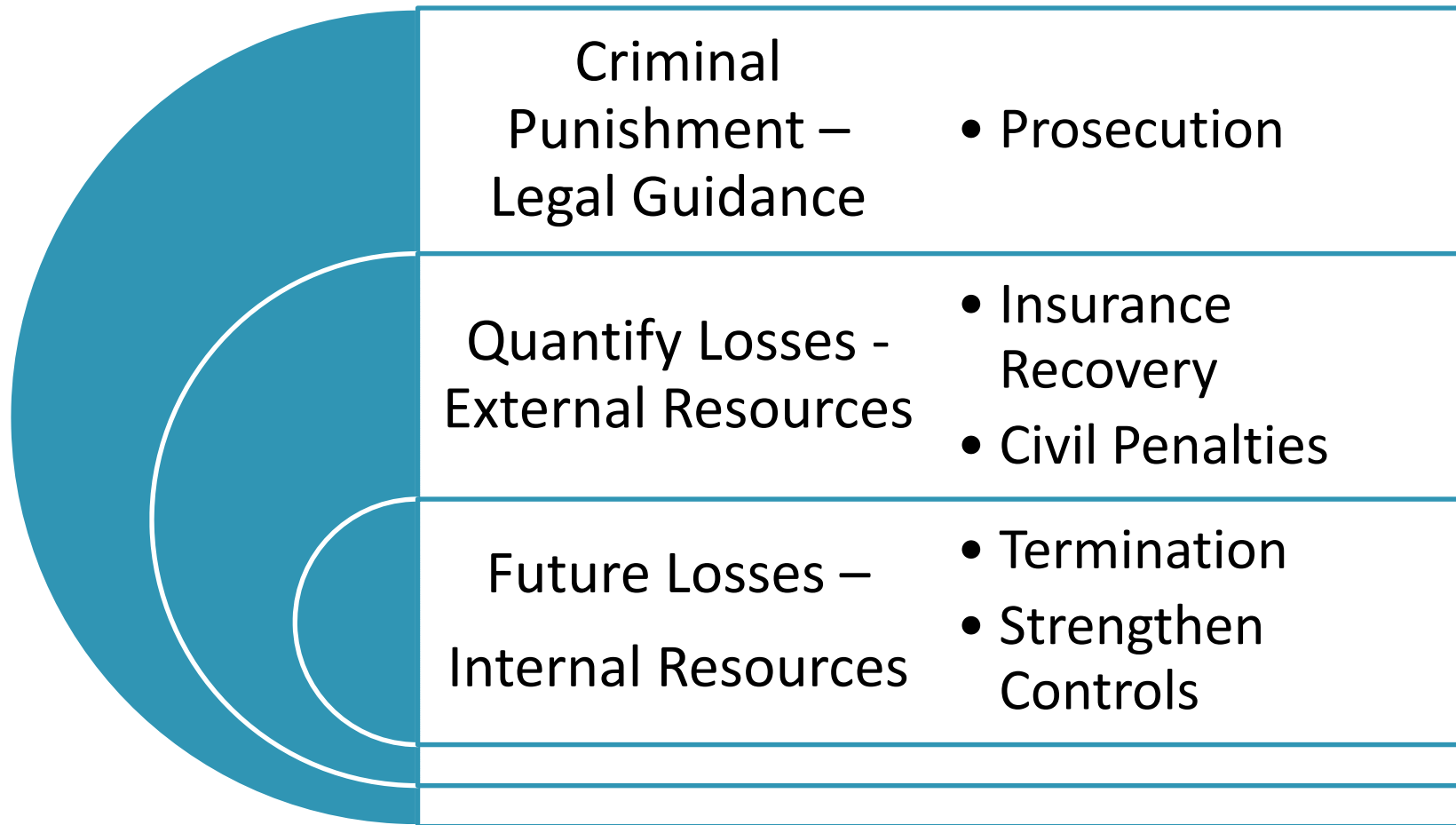
- ✓ Anonymous phone call or letter
- ✓ Surveillance footage
- ✓ Documentary evidence
 - ✓ Direct or Circumstantial

INVESTIGATION SCOPE & OBJECTIVES

- Termination
- Strengthen Controls
 - Update Policies and Procedures
- Insurance recovery
- Civil penalties
- Prosecution



INVESTIGATION SCOPE & OBJECTIVES



IDENTIFY INVESTIGATION TEAM

Determine expertise required to conduct desired investigation

Hotel Resources

- General Manager
- HR Manager
- Department Managers
- Finance Director or Controller
- Internal Auditors

External Resources

- Certified Public Accountant
- Certified Fraud Examiner
- Forensic Accountant
- Computer Forensic Specialist

Legal Guidance

- Legal Counsel
- Prosecutor
- Police
- FBI

SAFEGUARDS

➤ **Employee Protection (Whistleblower)**

- ❖ Harassment or Victimization
- ❖ Untrue Allegations

➤ **Confidentiality**

- ❖ Do not guarantee anonymity
- ❖ **Innocent until proven guilty**

➤ **Encourage speaking up**



GATHER EVIDENCE

There is no branch of detective science which is so important and so much neglected as the art of tracing footsteps.

- - *Sherlock Holmes, A Study of Scarlet (1888)*



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TYPES OF EVIDENCE

- Surveillance Footage
- Night Audit Workpapers
- Electronic Trails
- Accounting Documents
- Witness accounts – guests and employees
- Physical Evidence in Office

New Resource....

facebook

TYPES OF EVIDENCE

- **Night Audit Work papers/F&B Receipts**
 - ✓ Establish Chain of Custody
 - ✓ Direct Evidence
 - ❖ Employee changes tip from \$2.00 to \$12.00
 - ✓ Circumstantial Evidence
 - ❖ Report from POS system - Suspects tip percentage averages 40% of sales

TYPES OF EVIDENCE

➤ **Electronic Trails**

- ✓ Secure data to ensure admission into court
- ✓ Direct Evidence
 - ❖ Electronic check register with a document trail that the payee name was changed to suspects name
- ✓ Circumstantial Evidence
 - ❖ Deleted email from vendor inquiring how much they can charge for a product and still go unnoticed



TYPES OF EVIDENCE

➤ **Accounting Documents**

- ✓ Establish chain of custody
- ✓ Direct Evidence
 - ❖ Copy of deposited check endorsed by suspect
- ✓ Circumstantial Evidence
 - ❖ Journal entry reclassifying a personal expense to a miscellaneous expense account

TYPES OF EVIDENCE

➤ **Physical Evidence in Office**

- ✓ Establish chain of custody
- ✓ Direct Evidence
 - ❖ Check from vendor to purchasing clerk
- ✓ Circumstantial Evidence
 - ❖ Voided check with valid signature – Evidence of “practicing” forgery

INTERVIEWING TECHNIQUES

Though silence is not necessarily an admission, it is not a denial, either.

-- Marcus Tullius Cicero



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INTERVIEWING TIPS FOR SUCCESS

Develop a rapport – *Establish common ground before questioning begins - “People Person”*

- Interviewing is an art not a checklist
- Select the right person for interview
 - *External party, Human Resources, Management*
- Be prepared to question “on the fly”
- Let the conversation flow - *Do not interrupt*
- Immediately document interview

INTERVIEW TYPES

➤ Information Gathering Interview

- ✓ Good interview is objective in scope
- ✓ Aimed at gathering information in a fair manner
- ✓ Listen to answers – *don't just listen for the answer you want*
- ✓ Informal low-key fashion – *leave out authority*
- ✓ Non-threatening to elicit cooperation
- ✓ Educated questions based upon known evidence
- ✓ Do not communicate everything you know

NON-SENSITIVE WORDS

Use

- Inquiry
- Review
- Ask a few questions
- Paperwork problems

Instead of

- Investigation
- Audit
- Interview
- Steal/Theft

INTERVIEW TYPES

➤ Admission Seeking Interview

✓ Conducted to support goal(s)

- ✓ Termination
- ✓ Civil litigation
- ✓ Criminal charges

An unqualified interviewer may not achieve desired goals and jeopardize fraud case



ADMISSION SEEKING INTERVIEWS

**How to conduct an admission seeking interview
will not be covered in this presentation**

**In-depth training is available from the Association
of Certified Fraud Examiners**

www.acfe.com

Professional Interviewing Skills (2 days)

Advanced Interviewing Techniques Workshop (3 ½ days)



AFTER THE FRAUD

- Design preventative and detective controls to prevent future losses

What controls has your Hotel put into place as a result of fraud?



SUMMARY

- **Fraud “Red Flags”**
- **Hotel Fraud Schemes**
- **Fraud Prevention and Detection**
- **Fraud Response Plan**
- **After the Fraud.....**

QUESTIONS?

