



1



2



3



JEFF DEHART
CIA, CFE, CISA, CBCP

- Principal with Stinnett & Associates
- Developed and currently overseeing Stinnett Vendor Risk Management Services business line, providing support for all vendor risk-related activities for the firm's clients.
- Over 30 years of experience in both Audit and Information Technology
- Worked for several large organizations including Williams Companies and Magellan Midstream Partners
- Has held such positions as Associate General Auditor, Director of Audit Services, and Information Technology Manager

EXPERIENCE

- Enterprise Business Continuity Planning
- Construction Management Auditing And Consulting
- Inventory Management Advisory
- Internal Audit Management Services
- Business Process Re-engineering
- Oil And Gas Field Operations
- Aerospace Manufacturing and MRO (Maintenance, Repair And Operations)
- IT Network Security
- SCADA Security And Operations Control



Vendor Risk Management Services

4



STEVE KIENLEN
CPA, CIA, CFE

- Senior Manager with Stinnett & Associates
- Developed and currently managing Stinnett's Vendor Risk Management Services business line. During the past few years, our VRMS team has enabled our clients to implement numerous process improvements as well as experience actual cost recoveries exceeding \$6 million.
- Nearly 20 years of experience in Audit, Operations and Finance.
- Worked for several large organizations including Dell Technologies and EY.

EXPERIENCE

- Internal Audit Management Services
- Supply Chain
- Not-for-Profit Management
- Public Accounting
- Compliance and Fraud Investigations



Vendor Risk Management Services

5



AGENDA

-  Risks Associated with Vendors
-  Examples of Vendor Issues
-  Elements of an Effective Vendor Risk Management Program

6



7



8




9

stinnett

VENDOR RISK

ERRORS AND MISUNDERSTANDINGS :

- ▲ Unclear contract terms.
- ▲ Accidental use of wrong rates.
- ▲ Unclear or vague requirements.
- ▲ Costs not included in the original estimates.
- ▲ Scope creep or changes to requirements.
- ▲ Misunderstood terms for charge-throughs.
- ▲ Lack of proper allowance for markups.
- ▲ Lack of clear definition of allowable expenses and per diems.
- ▲ Responsibilities for permitting and inspection.




10

stinnett

VENDOR RISK

FRAUD :

- ▲ Perpetrated by the vendor
- ▲ Collusion between the vendor and company employees
- ▲ Perpetrated by the employee (fake vendor)



11

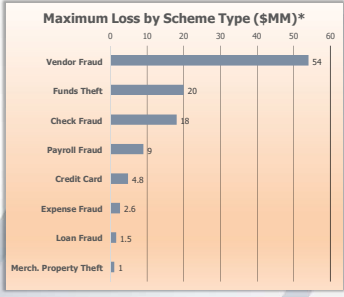
stinnett

VENDOR RISK

FRAUD :

According to a recent CNBC Report:

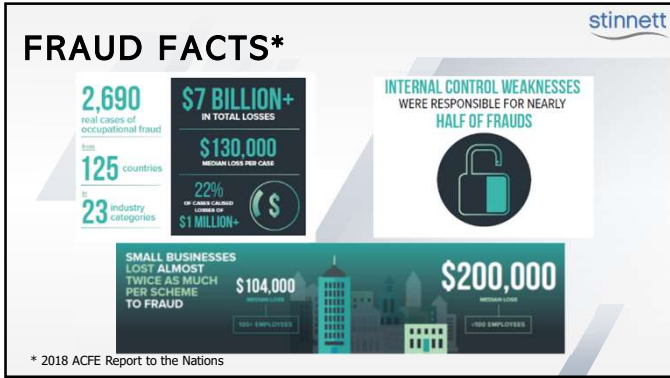
- ✓ Employee-related theft and fraud is costing U.S. businesses \$50 billion annually.
- ✓ U.S. businesses affected by employee theft lost an average of \$1.13MM in 2016.
- ✓ Small and midsize businesses were hit disproportionately, representing 68% of the cases; median loss: \$289K in 2016.



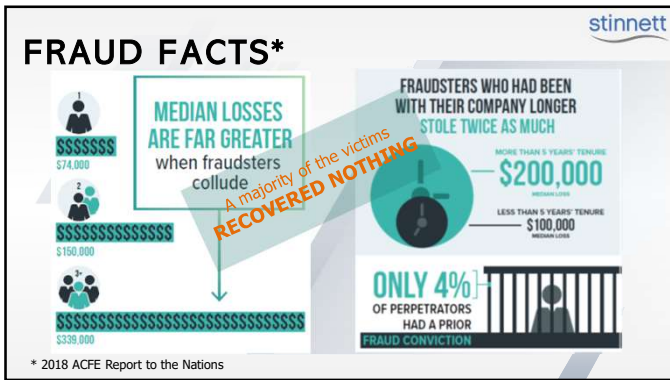
Scheme Type	Maximum Loss (\$MM)
Vendor Fraud	54
Funds Theft	20
Check Fraud	18
Payroll Fraud	9
Credit Card	4.8
Expense Fraud	2.6
Loan Fraud	1.5
Merch. Property Theft	1

Source: 2017 Hiscox Embezzlement Study

12



13




14



15

MARKUPS stinnett




Issues with markup errors include:

- 1 Markups on items that should not be allowed, such as per diems and employee expenses.
- 2 Markups for office equipment use.
- 3 In most cases, markups are allowed for work the contractor "farms out" to subcontractors. However, we have seen cases where they will create a "subcontractor" within their company, move the work to that division and charge the subcontractor markup.
- 4 Markups that are beyond the agreed amount.

16


COLLUSION WITH VENDOR stinnett



- 1 Vendor: Fire and security systems and maintenance
- 2 Supervisor in security office who oversaw fire safety and security systems colluded with vendor to create a fake company with "fire safety" in title
- 3 Fake company submitted bogus invoices for 10 years (\$2.6 million over 5 years was uncovered due to document retention policy)
- 4 Discovered randomly by another employee who actually performed the services and saw the invoices on admin's desk
- 5 Supervisor received about 90% of the invoice payments
- 6 Red flag: Supervisor regularly entered \$250,000 poker tournaments and casinos would send a jet to pick him up

17

CONFLICTS OF INTEREST stinnett




- 1 **EXAMPLE 1: Undisclosed ownership in a vendor or subcontractor.**
 - 2 Wife of employee subcontracting through hired vendor.
 - 3 Employee leasing trucks to vendor for use on company jobs.
- 2 **EXAMPLE 2: Vendors owned by a family member:**
 - 3 Daughter and son-in-law working for vendor. Using their middle names as their last name for camouflage.
 - 4 IT Director "hiring" a vendor to perform consulting work. Vendors were actually run by his wife, son and daughter-in-law. No actual work performed.

18

stinnett

GHOST EMPLOYEES



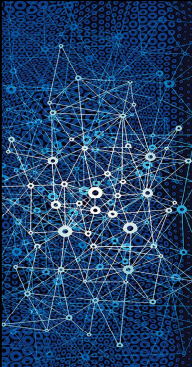
Recently, investigated a fraud case where the vendor's project manager charged time for a large number of employees on the job.

- 1 Upon investigation, this "team" consisted of his mother, brother-in-law, daughter, friend and couple of other random individuals.
- 2 This contributed to almost \$2 million in overcharges to a large construction project.
- 3 Fortunately, our client had a little over \$2 million retained from billings and did not lose the money.
- 4 The project manager absconded but was later arrested and prosecuted.

19

stinnett

OH THE TANGLED WEB...




- 1 Original conflict of interest discovered between an employee of our client and vendor #1 (employee's wife owned a company that subcontracted with vendor). Not disclosed, but vendor assumed everyone knew and "that is just how you do business."
- 2 Vendor #1 revealed a conflict that another client employee had with vendor #2. Assumed the conflict was a relationship between employee and vendor #2.
- 3 This client employee was approving all the invoices for vendor #2.
- 4 Review of state filing documentation revealed employee was part owner of an LLC, which was part owner of vendor #2.
- 5 Other partial owner of vendor #2 also did business with the client.
- 6 Do you require your vendors to sign a conflict of interest statement?

20

stinnett

YIELD TO TEMPTATION



ING Financial

- ✓ Nathan Mueller – employee in the reinsurance division.
- ✓ One of three employees with the authority to request or approve checks up to \$250k.
- ✓ Each of these employees knew each other's password, a stated "workaround" if someone was out of the office.
- ✓ He would request a check, then log in as someone else and approve it.
- ✓ Registered "Ace Business Consulting" with our secretary of state, got a federal ID number, and opened a bank account at a major bank with lots of branches in Minnesota.
- ✓ Ended up stealing nearly \$8.5MM over 4 years.

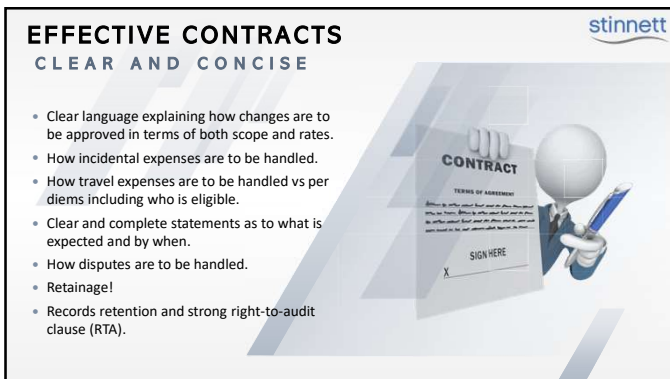
21



22



23



24

EFFECTIVE CONTRACTS stinnett


RTA EXAMPLE

Records and Audit. Contractor is required to maintain **receipts, canceled checks, vouchers, records, invoices for purchases, rate schedules,** etc. to sufficiently document and properly reflect all costs and expenditures incurred by Contractor, and the disposition of any materials, tools, or equipment provided by Company. Such records maintained shall include, but not be limited to, support for costs invoiced to the Company, all direct and indirect costs incurred by the Contractor, and other evidence which would enable Company employees to evaluate Contractor's compliance to Company's policies and procedures. **All costs and expenditures incurred by Contractor in the completion of the Work shall be recorded in such form and detail as to enable ready computation and audit of such costs.** Contractor shall preserve and make available all such records for a period of three (3) years after completion or termination of the Work. Contractor will require all subcontractors to comply with the provisions of the paragraph by insertion of these requirements in a written agreement between Contractor and subcontractor.

25

VRM - CYBERSECURITY stinnett


- Access to your systems
- File and data transfers
- Dedicated line or VPN access



26

VRM – ETHICS POLICIES stinnett

- Do policies describe conflict of interests and gift acceptance expectations?
- Are ethics expectations clearly explained to vendors and employees?
- Are vendors and employees required to disclose potential conflicts of interest?



27

VRM – PROCUREMENT AND INVENTORY



- Structured multiple bidding and awarding procedures.
- Vendor vetting and hiring may be centralized in Procurement, away from service requestor, creating an “arms length” situation.
- Strong inventory management procedures, including obsolete and scrap inventory handling.



28

VRM – VENDOR VETTING



- Effective vetting including background and credit checks on:
 - ✓ Company
 - ✓ Principal Management
- Effective controls around approving and adding new vendors.
- Segregated access to vendor master file and AP.
- Policies regarding sole-sourcing.



29

VRM – INVOICE AND QUALITY MONITORING



- Monitor incoming invoices to ensure they agree to contract terms and rates.
- Monitor trends in spending.
- Monitor for duplicate payments and multiple payments in rapid succession.
- Employee address and vendor address matching.
- Repeat offenders (next slide)



30

stinnett


THE "WHACK-A-MOLE" PROBLEM

FIND THE REPEAT OFFENDERS

Many times, companies will have restricted or forbidden the use of certain vendors due to problems or outright fraud.

These vendors may:

- Change their name and ownership.
- Shut down and set up under another name.
- Consider monitoring restricted vendors from time to time for new businesses to see if they have found a back door or side window to climb back in.



31

stinnett


THE "WHACK-A-MOLE" PROBLEM

FIND THE REPEAT OFFENDERS

How do you address this?

Detection is key:

- Thoroughly vet new vendors including background checks on owners.
- Review subcontractors to see if they are on restricted lists.
- Perform occasional audits to review new recent contractors.



32

stinnett

AN EFFECTIVE VENDOR AUDIT PROGRAM



33

stinnett


VENDOR AUDITS

A KEY TO EFFECTIVE VENDOR RISK MANAGEMENT

Vendor audits have proven to be an effective, even critical, tool in managing vendors.

They do this by:

- Identifying new fraud schemes and bad players.
- Sending a message that “we are looking” and expect compliance to the agreement.
- Developing a reputation that the company is serious and will prosecute or cut off vendors who do not act with integrity.



34

stinnett

REALITIES



DIFFICULTIES


- Vendors do not always “embrace” an audit.
- Once we begin finding recoverable dollars or indications of “misbehavior”, vendors could become difficult.
- Vendors don’t always tell the truth or show you all you need to know.


35

stinnett

VENDOR AUDITS

A TYPICAL VENDOR AUDIT PROGRAM

- 

Perform data analytics on up to three full years of spend for service providers. These include looking for billing anomalies and potential fraud indicators to provide a risk-ranked listing of vendors.
- 

A number of top risk vendors (usually 20-40) are selected for additional testing including sampling invoiced charges against approved contracts and rate sheets. This process is helpful in confirming those vendors that may of most interest.
- 

For each vendor, a specific audit is performed that builds on the testing in the previous step and includes research into the ownership of the company and the relationship to the customer including customer employees. Depending on the needs of the customer, this may include an onsite review of records at the vendor’s location.

36

VENDOR AUDITS
INITIAL DATA ANALYTICS

stinnett

- Statistical Analysis / Process Improvement**
 - Activity Swing by Dollar: (Multi-Month or Multi-Year)
 - Activity Swing by Percentage: (Multi-Month or Multi-Year)
 - High Concentration of Spend: (Multi-Year or Based on Additional Criteria)
 - Five Payments or Less
 - Frequent Invoices
 - Large aggregate spend
 - Per Vendor or time frame
 - Can be Multi-Year
- Potential Fraud / Control Circumvention**
 - Proportion of all vendor invoices billed to client based on invoice sequence
 - Concentration of vendor invoice activity by project manager and/or invoice approver
 - Match between Vendor and Employee information (such as phone, address, name, including fuzzy match)
 - Duplicate Payments - Date and Amount
 - Duplicate Payments - Invoice # and Amount
 - Round Invoice Amounts
 - Invoices Ending in .99
 - Invoices Ending in 9

37

VENDOR AUDITS
TYPICAL TESTING

stinnett

- Initially Reviewed at Client**
 - Applicable General Services and Maintenance Agreements and contracts, and all related parts, Exhibits, Addendums, Work Offers, Work Change Orders, and/or Rate Sheets
 - Insurance Certificates
 - Annual Financial Statements
 - Invoices and available supporting documentation
 - Available public records on vendor on principals
 - Vendor articles of incorporation or state registry
- Tested On-Site at Vendor**
 - Interviews with key management and administrative personnel at the vendor
 - Vendor and Employee Master Files; payroll data
 - 1099s
 - Accounts Receivable and Accounts Payable Registers
 - Check Registers, Bank Statements, Credit Card Statements, Corporate Officer Expense Reports
 - Vendor Invoices and Supporting Documentation

38

CLOSING SUMMARY

Given how much businesses rely on vendor relationships for successfully competing in their markets, it is critical to consider and actively manage all aspects of vendor risk management to limit exposure to failures, quality issues and even fraud.

VRM

stinnett

39

QUESTIONS?

JEFF DEHART, CIA, CFE, CISA, CBCP
PRINCIPAL, STINNETT & ASSOCIATES
Jeff.Dehart@stinnett-associates.com



STEVE KIENLEN, CIA, CFE, CPA
SENIOR MANAGER, STINNETT & ASSOCIATES
Steve.Kienlen@stinnett-associates.com
