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CFMA Midwest Regional
Conference: September 23, 2019

Schemes, Scams & Occupational Fraud

Joshua B. Levy
Eric J. Meier



Eric Meier Background

- Double Badger
- BBA – Finance and Risk Management and Insurance
- More than 20 trials
- Worked on 8 figure cost overrun claim for Milwaukee Brewers stadium
- Brief cameo appearance on Season 2 of American Idol



Josh Levy Background

- Double Badger
- Prior experience as in-house counsel for general contractor
- Presents annually to Milwaukee CFMA Chapter
- Formerly employed expense reimbursement off-book tactics before sounder controls at new firm (virga principle)



Husch Blackwell Construction Academy

- Husch Blackwell's Construction Academy works to provide the industry with an understanding of the legal fundamentals in today's complicated environment. Our Construction Academy was developed with the belief that value is unique to the client, knowledge is created in application, and both need a forum of partners to share what has been learned in order to propel organizations forward.

The Fence

Three contractors are bidding to fix the White House fence; one from Chicago, another from Dallas, and the third from Fort Lauderdale.

They go with a White House official to examine the fence.

Fort Lauderdale

\$900

\$400 for material,
\$400 for my crew, and
\$100 profit for me.

Dallas

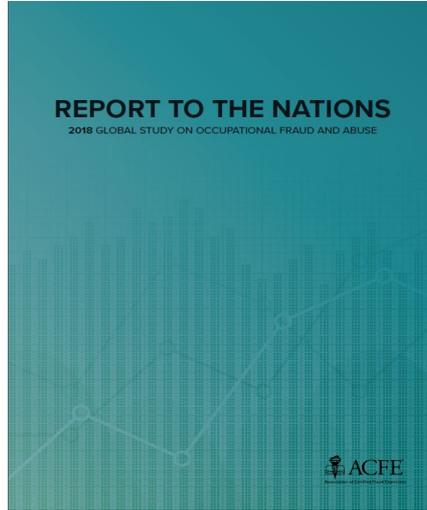
\$700

\$300 for materials,
\$300 for my crew, and
\$100 profit for me.

Chicago

\$2,700

\$1,000 for you,
\$1,000 for me,
and we hire the guy from Dallas.



TOP FRAUD TRENDS



High Cost of Fraud

- 5% of revenue lost to internal fraud and abuse each year
 - Median for construction industry is \$227,000
 - Median for all industries is \$130,000
- Cost of external assistance with investigation for insurance or criminal purposes
 - Lawyers
 - Forensic accountants
- Higher insurance costs in following year(s)



High Cost of Fraud

- Non-monetary loss can be *more* damaging
 - Loss of reputation
 - Loss of employee morale
 - Loss of productivity due to internal investigation



Recovering Funds is the Exception

- In 53% of the reported frauds, there was no recovery
- Money often gambled away
- For the 15% of reported frauds in which there was a full recovery, the source of recovery was usually an insurance policy



Insights on Fidelity Bonds

- Not to be confused with E&O Insurance, Fidelity Bonds specifically target deceitful acts, not mistakes or oversights. The distinction can sometimes be subtle, but can make all the difference when a claim is filed.
- It is an insurance product, commonly designed on a "claims made" basis.
- Depending on the amount of insurance purchased, successful claims will cover the full cost of the losses, up to the limit of the purchased insurance.



Insurance may not rush to pay your claim

- Watch your internal controls if you expect your insurance to pay...



Reply from insurance company after fidelity bond claim filed

Underneath that statement, each application includes the following question in bold typeface (underlined where indicated):

The correspondent account, suspense account, or transit account is used most often by dishonest employees. Are all correspondent accounts, suspense accounts, and transit accounts balanced and reconciled regularly and completely balanced and reconciled by a second person at least monthly?

On the application, the Bank answered "Yes" to this question.

Additional reply from insurance carrier

The walkthrough of examples enclosed with your letter states as follows: "Mr. [REDACTED] was responsible for reconciling the general ledger balance to the correspondent bank account statement and therefore the resulting differences were not detected by other bank personnel." This statement suggests that the correspondent account was not completely balanced and reconciled by a second person at least monthly.

[REDACTED] reserves the right to rescind the bond *ab initio* if it is determined that the Bank made misrepresentations or incorrect statements of materials facts on the bond application.

Tips from the Insurance Experts

- Jamie Vanderveldt—R&R Insurance

<https://www.myknowledgebroker.com/employee-directory/jamie-vanderveldt>

- Look closely at the Management Liability and Cyber Insurance Applications
 - Speak to different types of coverages (D&O), Fiduciary, Employment Practices, Crime, Kidnap and Ransom etc.
 - Also provides an outline of good thoughts to self-evaluate an internal program

Tips from Insurance Experts

- Sean Coykendall—Lockton Insurance

<https://www.linkedin.com/in/seancoykendall/>

- Note that “cybercrime” combines 2 distinct product lines—cyber and crime
- Policy wording and exclusions are designed to keep one policy line from covering risks intended to be covered by another.
- Focus on the loss as opposed to the manner of theft.



Most Fraudsters Have No Prior Criminal History

- 89% not previously charged or convicted
 - However, only about 40% of frauds are ever reported due to perceived reputational risk
 - Background checks and reference checks are still important
- Most do not take a job with intent to commit fraud, it is often a crime of opportunity

Which one looks suspicious



\$3 million



\$4.6 million



\$1.0 million



\$31 million



\$20 million



\$1.1 million



Who Commits Occupational Fraud?

- Largest frauds are committed by upper management, but employees commit fraud more frequently
 - Higher level of authority leads to less oversight and supervision, which leads to larger dollar frauds

• Employee	\$50,000	44% of all frauds
• Manager	\$150,000	34% of all frauds
• Owner/executive	\$850,000	19% of all frauds
 - Employees less likely to steal due to low wages than due to desire to “even a score”



Who Commits Occupational Fraud?

- Frauds are most frequently committed by trust employees
 - Accounting employees
 - Check tampering, billing and corruption
 - Effective controls:
 - Check the audit log of your accounting software
 - Compare payee on checks clearing bank to payee listed in check register
- Operations employees
 - Corruption, non-cash and billing



Behavioral Red Flags

- Be aware of these:
 - Living beyond means (expensive houses, cars, RVs, trips, etc.)
 - Financial difficulties and high personal debt
 - Unusually close association with vendor/customer
 - Control issues, unwillingness to share duties
 - Addictive behaviors; gambling, drinking and drug use



Tips are the Top Method of Detection

- For organizations *with* hotlines, 46% of frauds were detected by tips
 - 53% of tips were from employee
 - 21% were tips from customers
 - 8% of tips were from vendors
- For organizations *without* hotlines, only 30% of frauds were detected by tips



Prevalent Occupational Frauds in Construction Industry

- Top schemes by frequency
 - Corruption 42%
 - Billing 37%
 - Expense Reimbursement 23%
 - Non-cash 23%



CORRUPTION



What is Corruption?

- Employee wrongfully influences a business transaction in order to procure some benefit for themselves or another person or entity
 - Bribery
 - Economic extortion
 - Illegal or improper gratuities
 - Conflicts of interest



Bribery

- Kickbacks – undisclosed payments *offered* and made by vendors to employees of purchasing companies
 - Cash
 - Expensive gifts, free travel, lavish entertainment
 - “Loans,” whether repaid or not
 - Overpaying for purchases, e.g., paying \$20,000 for a \$5,000 car
 - Hidden interests in business transaction



Bribery

- Bid rigging – contract promised to one party even though for the sake of appearance, several other colluding parties also present a bid
 - Usually involves a payment to an employee of the purchasing company to assist the vendor in winning a contract



Economic Extortion

- Flip side of bribery
 - Purchasing company employee *requires* payment to select a vendor
 - Transactionally the same as a bribe



Illegal or Improper Gratuities

- Similar to a bribe, but usually occurs *after* purchasing decision is made
 - From the successful bidder
- Can morph into a bribery scheme
- May be a way to “test” for openness to a bribe
- Often in the form of expensive meals, gifts, travel and entertainment
 - New windows, a finished basement, tickets to college bowl games, etc.



Conflict of Interest

- Employee, manager, executive or partial owner has an often undisclosed economic or personal interest in a transaction that adversely affects the purchasing company.
 - Potential outcomes:
 - Rigged bids
 - Inflated prices
 - Submission of false invoices
 - Sub-quality substitutions



Red Flags for Corruption Schemes

- Contracting employee with lifestyle that exceeds what salary could support
- Approved contract change orders which lack sufficient justification
- Unexplained or unreasonable limitations on the number of potential subs contacted to bid
- Continuing awards to subs with poor performance records
- Unusual bid patterns



Red Flags for Corruption Schemes

- Same company always wins a particular procurement
- Same suppliers submit bids and companies seem to take turns being the successful bidder
- Some bids are much higher than published price lists, previous bids by the same firm, or engineering cost estimates
- Fewer than normal number of competitors submit bids



Red Flags for Corruption Schemes

- Losing bids do not comply with bid specs or only one bid is complete and other bids are poorly prepared
- A successful bidder subcontractors work to competitors who were unsuccessful bidders on the same work

Anti-fraud controls for corruption

- Continuously monitor for unusual employee behavior or unusual employee relationships
 - Too close of a relationship, frequent meals & entertainment, etc.
- Monitor for unusual bid patterns previously described

Anti-fraud controls for corruption

- Develop a database of historical data
 - For each bid received and awarded
 - Actual costs for each contract
 - Unit prices
 - Other

Anti-fraud controls for corruption

- Trend and compare historical data
 - Year to year
 - Project to project
 - By sub/vendor
 - By market
 - By raw material
 - By work (new, rehab, repair)
 - By purchasing person or project manager
 - Versus market pricing
 - Against competitor or industry metrics
- Look for departures from trends, or anomalies



BILLING FRAUD



Billing Schemes

- Any scheme in which a person causes his or her employer to issue an irregular payment for goods or services
 - Inflated or false pay applications
 - Billings for work not performed
 - Change order abuse
 - Billing equipment or personnel at rates that are higher than agreed upon rate tables
 - Payments to fictitious subcontractors, suppliers and employees
 - Billing for costs not associated with the project



Inflated Pay Applications

- Pay apps need to be monitored and scrutinized closely for
 - Erroneous totals or line items
 - Roll-forward errors
 - Missing or disorganized billing backup
 - Inflated rates on invoices in excess of actual costs incurred or false invoices
 - Missing subcontractor lien waivers
- This will help safeguard against errors and potential fraud

Change order abuse

- Keep a close eye on the following
 - Appropriate justification for the change order
 - Numerous, unusual or unexplained change orders for a specific sub approved by the same employee
 - Pattern of low bid award followed by change orders that increase the price or scope of the contract, or extend the contract period
 - Vague contract specifications followed by change orders

Anti-fraud controls for billing fraud

- Scrutinize line items and quantities on pay applications
- Maintain and monitor accurate schedules of value and percentage of completion schedules
- Segregate the duty of billing from that of processing payments

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF WISCONSIN

UNITED STATES OF AMERICA

v.

CRIMINAL COMPLAINT

ROBERT G. BROWNELL
S30 W27710 Green Lane
Waukesha, WI 53188
(DOB: 1/14/61)

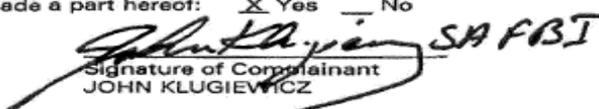
CASE NUMBER: 04-M-528

I, John Klugiewicz the undersigned complainant, being duly sworn state the following is true and correct to the best of my knowledge and belief. Between on or about May 1, 2000 and on or about July 16, 2004, in the State and Eastern District of Wisconsin, Robert G. Brownell did knowingly conspire with persons known and unknown to commit mail fraud, in violation of Title 18, United States Code, section 1341; and money laundering, in violation of Title 18, United States Code, section 1956(a)(1)(A)(i); and during the time period of the conspiracy, overt acts in furtherance were taken by members of the conspiracy, including on or about April 29, 2004, in the State and Eastern District of Wisconsin, a \$175,000 check was transferred from Mann Brothers to an entity controlled by Brownell; all in violation of Title 18, United States Code, sections 1349 and 1956(h).

I further state that I am a Special Agent with the Federal Bureau of Investigation, and this complaint is based on the following facts:

Please see the attached affidavit.

Continued on the attached sheet and made a part hereof: Yes No

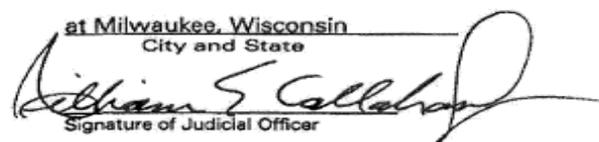
 SA FBI
Signature of Complainant
JOHN KLUGIEWICZ

Sworn to before me and subscribed in my presence,

October 12, 2004
Date

The Honorable William E. Callahan
United States Magistrate Judge
Name & Title of Judicial Officer

at Milwaukee, Wisconsin
City and State


Signature of Judicial Officer

I, John Klugiewicz, being duly sworn under oath, state as follows:

A. Overview

1. I am a special agent of the Federal Bureau of Investigation. I have been an agent for more than 18 years. I am currently assigned to the investigation of white-collar fraud. I have a degree in accounting and am a Certified Public Accountant.

2. I make this statement based upon personal knowledge as well as on information supplied to me by others. To the extent that certain information described below was not personally observed, I believe it to be truthful and reliable. In particular, I note that the following includes statements that are inculpatory, have been corroborated by others, and are consistent with financial records that I have reviewed.

3. Based on the results of an investigation to date by the FBI and United States Attorney's Office, I believe that probable cause exists that **Robert G. Brownell** (d/o/b 1/14/61) did knowingly conspire with persons known and unknown to commit mail fraud, in violation of Title 18, United States Code, sections 1341 and 1349. The mail fraud conspiracy resulted in losses to a Wisconsin construction business well in excess of \$3 million.

4. In addition, the investigation has established that Brownell and others known and unknown have conspired to commit money laundering for the purpose of using proceeds to promote the fraud through the use of funds for political campaigns. According to information obtained to date, the following amounts were involved:
(a) approximately \$31,000 was used for campaign contributions to President George W. Bush; (b) approximately \$22,000 was used for the U.S. Senate campaign of Russ

Darrow; and (c) approximately \$21,500 was used for the 2002 gubernatorial campaign of Scott McCallum. The evidence reviewed to date suggests additional amounts of money for political purposes may have been involved as well. Because such activity involves an agreement to engage in financial transactions utilizing proceeds of a specified unlawful activity (mail fraud), with the intent to promote such activity, I believe probable cause exists that Brownell's conduct also violated Title 18, United States Code, sections 1956(a)(1)(a)(i) and (h).

B. Bielinski Brothers

5. Bielinski Brothers, Inc. is a Waukesha County-based residential and commercial construction company. It operates under various corporate names, including Bielinski Homes. Bielinski is involved in more than \$100 million in new home construction each year.

6. Robert Brownell began working for Bielinski Brothers in 1995. From approximately 2001 until July of 2004, Brownell served as Chief Executive Officer of Bielinski Homes. He was paid approximately \$175,000 per year.

7. As part of his duties, Brownell approved the payment of invoices associated with development and new home construction. These invoices included work for grading and similar activity at the start of the construction of a residential subdivision.

8. Mann Brothers, Inc. is an Elkhorn-based construction company that provided grading and other construction work for Bielinski Homes. According to a summary review of records, as well as statements of witnesses, Mann Brothers does approximately \$20 million for Bielinski each year.

C. Kickback and Embezzlement Scheme

9. Besides working for Biellinski, Robert Brownell maintained various businesses in partnership with others. They included: (a) DSI, or Development Services, Inc.; (b) SEWMA, or Southeastern Wisconsin Market Analysts; (c) Georgetown Holdings, LLC.; and (d) Belize, LLC.

10. As part of a scheme to defraud Bielinski and others, Brownell approved invoices from Mann Brothers knowing that the invoices had been inflated. Once Mann Brothers was paid, the excess from the invoices was split between Brownell and Robert Mann, at the time a part owner of Mann Brothers. Brownell's share was given to him in the form of checks from Mann Brothers to DSI and/or SEWMA.

11. As part of this investigation, I interviewed Robert Mann. Mann provided information to the FBI and United States Attorney's Office under a grant of limited immunity. Under the immunity, Mann may still be prosecuted for his actions, but certain specific statements may not be used against him. Mann said that prior to the start of a project with Bielinski Brothers, he would discuss with Brownell the amount of inflated charges that be included on a particular project. That amount varied by the size of the project, the actual work that was needed, and the potential budget. Mann and Brownell would then come to an agreement on the amount of the inflated charge.

12. Also according to Mann, after Mann Brothers received payment from Bielinski Brothers, a check would be issued to Brownell through one of his companies – usually DSI or SEWMA. The amount of the payment would be 50 percent of the overcharge. Brownell would provide an invoice from his company to Mann to justify the payment.

13. Mann said his share of the inflated charges were kept within the Mann company.

14. According to information reviewed to date, the amount of inflated charges to Bielinski Brothers as part of the scheme exceeded \$2 million.

15. In addition, as part of my investigation, I interviewed a person (hereafter "co-conspirator #1") who did engineering work on actual Georgetown projects. These projects included residential construction. Co-conspirator #1 stated that at the direction of Brownell, co-conspirator #1 routinely issued bills to Bielinski Brothers for this work, even though the work was not done for Bielinski. The payments were then issued by Bielinski.

16. As a result, Bielinski Brothers paid invoices from co-conspirator #1 (and his business entities) on projects that were the private business interests of Brownell. Based on the investigation to date, the amount of money paid by Bielinski exceeded \$300,000.

17. Additional records reflect that Bielinski Brothers paid in excess of \$500,000 for a Florida condominium owned by Belize, LLC, another Brownell entity. The payment was requested by Brownell and was made to appear as a legitimate Bielinski expenditure. Similar suspect billings appear to have been paid by Bielinski, with the proceeds linked to the personal expenses of Brownell and others.

18. According to Bielinski Brothers officials, the kickbacks and other payments described herein were not authorized.

19. On September 2, 2004, Assistant U.S. Attorney Matthew L. Jacobs and I interviewed Brownell. During that interview, Brownell admitted the fraudulent acts described above. Although his description does not match completely with the other witness statements described above, Brownell admitted taking kickbacks on inflated invoices from Mann and admitted improperly having Blelinski Brothers pay invoices on Brownell's private business interests, including the condominium purchase.

20. Further investigation reveals that the United States Postal Service was utilized for the fraud, including for the transfer of checks from Biellnski to Mann Brothers for payment on the inflated invoices and for the transfer of kickback check payments from Mann Brothers to the business entities utilized by Brownell, in care of Brownell's accounting firm.

Expense Reimbursement/Credit Card Schemes





Expense Reimbursement/Credit Cards

- Any scheme in which an employee makes a claim for reimbursement for fictitious or inflated business expenses
 - Employee files fraudulent expense report, claiming personal travel, nonexistent meals, etc.

Red flags for expense reimbursement /Credit card schemes

- Purchases that do not appear to be business related
- Original documents supporting expenses missing
- Receipts are altered
- Expenses in round dollar amounts
- Expenses just below receipt submission threshold
- Expensive business lunch/dinner expenses without names/organizations of attendees and business purpose noted

Anti-fraud controls for Expense reimbursement/credit cards

- Get supporting documentation for purchases
 - Original receipts – not just credit card statement
- Address possible weaknesses in review process
 - No review/weak review
 - Wrong person doing the review
- Question any potentially inappropriate purchases
- Strengthen your expense/purchase related policies
- Do not allow personal purchases on corporate credit cards as a standard practice

NON-CASH SCHEMES





Non-Cash Fraud Schemes

- Any scheme in which an employee steals or misuses non-cash assets (fixed assets or inventory) of the victim organization
 - Employee steals tools, equipment, materials or supplies from a jobsite, warehouse or storeroom
 - Employee causes materials to be delivered to a non-jobsite location for personal use
 - Employee misuses (or borrows without approval) tools or equipment for personal use



Red Flags for Non-Cash Schemes

- Shrinkage or missing tools, materials equipment, etc.
- Missing tools that turn up the next day
- Employees who frequently visit the jobsite, warehouse or storeroom outside of work hours

Anti-fraud controls for non-cash schemes

- Maintain physical security of inventory and supplies
 - Secure significant assets when not in use
 - Consider security cameras at job sites

Anti-fraud controls for non-cash schemes

- Conduct physical inventory counts on a periodic basis
 - Should be someone independent of the purchasing and warehouse functions
 - Investigate discrepancies

Cost effective methods to help prevent fraud

- Track changes in the Schedule of Value
- Track changes in the contingency account
- Compare change order signature dates to the actual time the work was completed

Cost effective methods to help prevent fraud

- Inventory the lien waivers
- Maintain a list of purchased equipment
- Conduct supplier confirmations
- Prove reimbursable charges
- Compare drawings/spec material volumes to claimed actual volumes

Cost effective methods to help prevent fraud

- Have every contractor/employee on job site sign in and out
- Check estimates for accuracy. Make sure labor rates, calculations and correspondence with drawings are correct
- Compare job-cost estimates with actual costs. Review any discrepancies

Cost effective methods to help prevent fraud

- Get quotes from 2 or more vendors for material estimates above a certain amount
- Make purchases with pre-numbered purchase orders. Match them with invoices and reports before making payments
- Use specific job numbers, phase codes and work order numbers on any on-site communication



Cost Effective Methods to Help Prevent Fraud

- Involve numerous employees in the accounting process
 - Have two staff review and sign all checks over a set amount
 - Have one employee periodically independently review payments to vendors
 - Appropriate segregation of duties



Cost Effective Methods to Help Prevent Fraud

- Consider establishing a fraud and ethics hotline
 - Over 40% of all fraud are detected by a tip
 - Fraud losses are estimated to be 50% smaller for organizations with hotlines than those without



Questions?

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