



Forensic Investigations – Sarbanes Oxley Testing & Continuous Auditing

Ryder Audit Services
2009



Presentation Overview

Forensic Investigations while performing SOX testing and Continuous Auditing

6th year of SOX 404 Testing

Majority of your Auditee's "Know the Drill"

Presentation will teach you how to get more value out of all the time and effort you put into your compliance testing including how to look for fraud while performing your SOX 404 testing.

Give "real life" examples of how to conduct pro-active fraud analysis by creating an on going continuous auditing program.

Accounting Center Key Controls

Key Accounting Center Sarbanes-Oxley controls include the following:

Cash

- ▶ Bank statement reconciliations
- ▶ Bank statement review for reasonableness

Accounts Payable

- ▶ Vendor addition review
- ▶ Batch payment approval
- ▶ Monthly accounts payable expense accrual
- ▶ Travel and expense report review

Accounts Receivable

- ▶ Application of customer payments
- ▶ Bad debt review

Revenue

- ▶ Review for potential revenue loss
- ▶ Accrual posting

Fuel Billing

- ▶ Variance research between pumped and billed

Inventory

- ▶ Parts obsolescence review
- ▶ Monthly liquid inventory review

Payroll

- ▶ Rate change approvals
- ▶ Supervision and approval of hours

Corporate Audit Overview

Identifying key controls to detect fraud

In order to maximize the value of Sarbanes-Oxley 404, each entity must ensure that the key controls in place not only ensure proper financial reporting, but also protect against fraud.

One common example is the accounts payable vendor set-up. Most account payable departments have a segregation of duties between who requests a vendor and who approves the vendor set-up in their financial system.

Most companies don't review the vendor's information to ensure that they are not an employee or contain the same critical information (i.e. address or telephone number) as an employee.

Accounts Payable - Vendor Setup Review

Sarbanes-Oxley Testing – Accounts Payable

Risks:

- **An unauthorized vendor is performing services for your company.**
- **A vendor who has not performed services is paid through your Accounts Payable function.**

SOX 404 Testing Procedure:

Obtain a listing of all vendors setup in the procurement system during the calendar year. Select a sample of XX vendors and perform the following:

- a. Ensure that each vendor has a completed Vendor Request Form.**
- b. Ensure that there is segregation of duties between the initiator and approver.**
- c. Ensure vendor has a valid Tax Identification Number.**

Accounts Payable - Vendor Setup Review

Sarbanes-Oxley results:

All vendors selected contained a valid Vendor Request Form with the appropriate approvals. In addition, each vendor had a valid Tax Identification Number.

NO EXCEPTIONS NOTED!

Value Added Step Results:

Internal Audit reviewed the vendor setup information against an employee listing and noted the following:

Ryder employees and immediate family members paid as vendors

- \$1,000,000 identified (appeared to be for legitimate services)
- Potential violation of Ryder's "Conflict of Interest" policy
- Innovative ways to get around the initial issue by setting up a company under a relative's name, company address with PO BOX

Semi-Annual Location Inventory

Sarbanes-Oxley Testing – Inventory

Risks:

- **Financial statements do not reflect a complete and accurate balance of parts and tires inventory at Fleet Management Solutions (“FMS”) shops.**

SOX 404 Testing Procedure:

Obtain the inventory report for the FMS location, and perform the following:

- Select 30 parts from the inventory report and confirm to actual quantity.**
- Select 30 parts from the floor and compare to the inventory report.**
- Verify independent count against location’s count. Any variances must be researched.**
- Obtain a final signed inventory report from the Location Manager and independent employee verifying the counts.**

Semi-Annual Location Inventory

Sarbanes-Oxley results:

All FMS locations tested passed the physical inventory. There were minor variances between Internal Audits count and the location's count. For all variances where the location was incorrect, the sample was expanded.

No significant internal control deficiencies noted!

Value Added Step Results:

Internal Audit reviewed the adjustments made to the inventory system before and after inventory dates, and noted the following:

Location Managers adjusting system inventory totals to reflect the inventory physically at the location.

Inventory – Manipulation of Inventory

Central Region

- The PLL (Parts Logistics Leader) altered inventory dates by transferring parts within his CBU to avoid parts obsolescence.
- The PLL would visit shops prior to inventory counts and create ROs in FIS for noted missing parts.
- The PLL would attend all physical inventory counts in his CBU (12 locations)
- The PLL would participate in inventory counts and clear majority of the variances
- The CBU had over \$71,000 in parts loss and over \$220,000 in obsolete inventory
- The investigation led to resignation of the PLL, demotion and suspension in the Shop management ranks

Midwest Region

- ▶ Practice of re-dating older parts by charging parts (not needed in the repair) to a RO and then taking the parts off the RO back into inventory. This transaction “re-sets” the part’s age to zero days with the FIS Inventory System and creates a situation that incorrectly undervalues obsolete inventory.
- ▶ PLLs were terminated and Service Managers received a final warning disciplinary letter and a reduction in bonus.

Travel and Expense Report Testing

Sarbanes-Oxley Testing – Travel and Expense

Risks:

- **Travel and expense transactions are processed for payment without the proper approvals.**
- **Expenses are coded to the incorrect account codes leading to possible financial statement misrepresentation.**

SOX 404 Testing Procedure:

Obtain a listing of all Travel and Expense (T&E) reports submitted for payment during the period. Select a sample of XX T&E reports and perform the following:

- Ensure all expenses contain supporting documentation.**
- Ensure the T&E reports are approved by the appropriate supervisor.**
- Ensure all expenses are coded to the correct account code.**

T&E – Improper Submission of Expenses

Sarbanes-Oxley results:

All T&E reports tested contained supporting documentation for expenses submitted and were properly approved by their direct supervisor. In addition, all expenses were properly coded in the expense reporting system.

NO EXCEPTIONS NOTED!

Value Added Step Results:

Internal Audit reviewed the expenses for discrepancies in timing, destination and vendor and noted the following:

- Entertainment Expense – falsifying the list of attendees (customers and Ryder employees)
- Supervisor knowingly approving inaccurate entertainment expenses in which the supervisor was present
- Non-traveling employees submitting numerous expenses for meals with other local Ryder employees
- Traveling employees submitting numerous expenses for meals and drinks with other Ryder employees that far exceeds per diem guidelines
- Inappropriate use of the executive perquisite allowance

Payroll Testing

Sarbanes-Oxley Testing – Payroll

Risks:

- Employee is paid incorrect payroll amount (i.e. incorrect quantity or rates).
- Payroll amounts are not properly recorded in accordance with GAAP.

SOX 404 Testing Procedure:

Obtain a listing from Human Resources of all employees paid during the calendar year. For the time period selected, select a sample of XX employees and perform the following:

- a. Ensure the rate paid to the employee agrees to their Employee Profile Form.**
- b. Ensure the quantity paid the employee contains supporting documentation.**
- c. Ensure the employee's pay is properly approved by their direct supervisor.**

Hourly Employee – Overtime Pay

Sarbanes-Oxley results:

All employees tested contained supporting documentation for rates and quantities submitted. In addition, all payroll amounts were properly approved by their direct supervisor.

NO EXCEPTIONS NOTED!

Value Added Step Results:

Internal Audit reviewed each type of pay, and noted the following:

Overtime disguised as differential pay

Numerous Service Managers reflected their locations' overtime payroll as less than it actually was by reporting a portion of overtime pay incurred under the differential payroll category. Keeping overtime pay under a certain threshold is considered a management initiative.

Bank Account Reconciliation Testing

Sarbanes-Oxley Testing – Bank Account Reconciliation

Risks:

- **Cash balance on the financial statements are incorrectly stated.**

SOX 404 Testing Procedure:

Obtain the monthly bank account reconciliation for three months in 2009, and perform the following:

- a. Agree balance, per the reconciliation, to the monthly bank statement.**
- b. Agree balance, per the reconciliation, to the GL cash balance.**
- c. Ensure reconciling items contain proper supporting documentation.**
- d. Ensure reconciliation is properly reviewed and approved.**

Bank Account Reconciliation Testing

Sarbanes-Oxley results:

All bank reconciliations agreed to supporting documentation and variances were properly researched and resolved. In addition, all bank reconciliations were properly reviewed and approved by the appropriate personnel.

NO EXCEPTIONS NOTED!

Value Added Step Results:

Internal Audit performed an analytical review and trend analysis for disbursements from the bank statement and noted the following:

Disbursement transactions

Internal Audit noted several consistent checks totaling \$4K, the limit for the location issuing the checks. After obtaining the checks, Internal Audit noted over \$200K in checks written out to the location's Finance Manager.

Fuel Reconciliation Testing

Sarbanes-Oxley Testing – Fuel Reconciliation

Risks:

- **Fuel balance on the financial statements are incorrectly stated.**

SOX 404 Testing Procedure:

Obtain the monthly fuel reconciliation for three months in 2009, and perform the following:

- a. Agree balance, per the reconciliation, to the system fuel inventory total.**
- b. Agree balance, per the reconciliation, to the physical fuel inventory.**
- c. Ensure reconciling items contain proper supporting documentation.**
- d. Ensure reconciliation is properly reviewed and approved.**

Fuel Reconciliation Testing

Sarbanes-Oxley results:

All fuel reconciliations agreed to supporting documentation and variances were properly researched and resolved. In addition, all fuel reconciliations were properly reviewed and approved by the appropriate personnel.

NO EXCEPTIONS NOTED!

Value Added Step Results:

Internal Audit reviewed each location with discrepancies between fuel dispensed and fuel billed, and noted the following:

Fuel dispensed to customers not billed

Internal Audit noted a specific location not charging customers for pumped fuel. The location was deleting the gallons pumped on the fuel ticket so that the system would not bill the customer. The Fuel Island Attendant was receiving kickbacks from the customer.

What is Continuous Auditing?

Continuous Auditing – Obtaining data at regular intervals. Utilizing scripts/functions from server or desktop for data analysis. Providing more frequent and timely analysis to better manage control deficiencies.

- Timely notification of gaps and weaknesses
- Requires an understanding of critical control points, rules and exceptions
- Testing of controls and risks
- Aids in identification of higher risk and exposure areas
- Technology is a key enabler

Examples of Continuous Auditing implemented in the following areas:

- Payroll – High gross pay
- Accounts Receivable – AR for sale of assets, Credit Memo
- Accounts Payable – Comchecks, PCard, Calling cards
- Inventory – Repairs with no parts or no labor
- Rental Activity – Missing miles

Barriers to Deployment

What are the common barriers in using or expanding the usage of continuous auditing techniques by Internal Audit Functions?

- Difficulty in understanding the benefits/lack of support
- Don't know where to start
- Don't have the people/skill sets
- Don't have the required tools
- Uncertain how to acquire and reconcile the data
- Unsure how to execute a project from beginning to end

Potential Operational and Compliance Benefits

Operational Benefits

- A transferred benefit to the organization
- Provides insight into the operations of the business through
 - Identifying trends/correlations that were not evident
 - Identifying and supporting the need for a business process change
 - Empowering management to make better decisions

Compliance Benefits

- May help meet certain regulatory requirements
- Potential cost savings

Continuous Auditing - PAYROLL

1) High Gross Pay

RISK: Excessive amounts paid to hourly employees

TEST STEP: Obtain supporting documentation for hourly employees getting excess of \$2K on a weekly basis.

RESULTS - The following exceptions have been noted:

- ▶ An hourly employee getting paid over \$25,000 in a week.
- ▶ Employees getting paid for salary advances without proper approval
- ▶ Employees getting paid for unearned vacation days

FREQUENCY: Weekly

Continuous Auditing - ACCOUNTS RECEIVABLE

2) Asset Sales

RISK: Transferring title of an asset and not collecting/posting the proceeds from the sale in a timely manner.

TEST STEP: Obtain open Accounts Receivable from Sales centers and review open balances of more than 30 days.

RESULTS: Sales Manager applying funds received from sale of one truck to another for covering up a previous defalcation (hiding checks). Sales Manager transferred title for a truck and kept cash for personal gain.

FREQUENCY: Monthly

Continuous Auditing - ACCOUNTS RECEIVABLE

3) Credit Memo

RISK: Unauthorized approval/issuance of the credit memo's

TEST STEP - Obtain all credit memo's issued in a month and review sample credit memo's for proper documentation and approval from the following categories:

- ▶ Highest amount (in total)
- ▶ Highest amount for customer accommodation

RESULTS:

- Credit memo's issued for repairs customer disputed
- Credit memo issued to hide the difference in the amounts on the billing system versus verbally agreed with the customers

FREQUENCY: Monthly

Continuous Auditing - ACCOUNTS PAYABLE

4) Comcheck (Method of getting cash to a driver in case of an emergency at a truck stop via check authorization code, check sequence number and other credentials)

RISK:

- No supporting documentation is retained for Comcheck issued
- Comcheck issued for personal gain

TEST STEP - Review list of all Comcheck transactions for the following:

- ▶ Identifying checks issued in even denomination (\$300, \$400, \$500)
- ▶ Identifying checks issued for the same amount multiple times
- ▶ Identifying users cashing more than \$800 in a day using Comcheck
- ▶ Identifying locations issuing highest amount of Comcheck

RESULTS - The following exceptions have been noted:

- ▶ Location management issued checks to himself and his supervisor did not review the locations expenses
- ▶ Drivers falsifying receipts for the supporting documentation

FREQUENCY: Monthly

Continuous Auditing - ACCOUNTS PAYABLE

5) PCard (Purchasing card – A charge card issued on behalf of the company to an employee for covering small dollars and repetitive business related purchasing expenses)

RISK:

- Use of the PCard for personal gain
- Use of the PCard to purchase items outside the Corporate Purchasing policies

TEST STEP - Review activity over a designated amount for selected cardholders and review the following:

- ▶ Use of unauthorized vendors
- ▶ Use of card at vendors not authorized
- ▶ Highest spender (by total amount)

RESULTS - The following exceptions have been noted:

- ▶ Employees using the card for personal use (at amusement park, cigarettes)
- ▶ Employees using the card for items (laptops, printers, monitors) not allowed by the corporate policy to purchased on the PCard
- ▶ In some instances the reviewer of the PCard expenses was at level lower in the organization than the Pcard holder

FREQUENCY: Monthly

Continuous Auditing - ACCOUNTS PAYABLE

6) Calling Card and Long Distance Code

RISK: Unauthorized use of the calling cards

TEST STEP - Review activity of all calling cards and long distance codes by reviewing the following areas:

- ▶ Highest amount (in total)
- ▶ Calls to foreign countries
- ▶ Frequent calls to non-business related numbers
- ▶ Terminated employee card activity

RESULTS - The following exceptions have been noted:

- ▶ Terminated employees calling cards used after the employee is no longer with Ryder

FREQUENCY: Monthly

Continuous Auditing - INVENTORY

7) Repairs with no labor /no parts

RISK:

- Manipulating inventory levels by creating repairs with excessive parts
- Not accounting for labor on the repair order to lower running costs

TEST STEP - RAS identifies top 5 locations with the following:

- ▶ No time charged on repairs, only parts
- ▶ No parts charged, only time

RESULTS - The following exceptions have been noted:

- ▶ In order to hide inventory shortages at a location, manager was creating “fake” repairs in the system with excessive amount of parts.
- ▶ Employees never charged time to the repair and the time should have been billed to the customer

FREQUENCY: Monthly

Continuous Auditing – RENTAL ACTIVITY

8) Missing Miles

RISK: Renting trucks for cash

TEST STEP - Review the top 5 locations with the following:

- ▶ Most number of units with missing miles
- ▶ Units with the most missing miles

RESULTS: Rental location managers renting units for personal gain

FREQUENCY: Monthly