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Hotline Calls Are ‘Best Defense’ Against Misconduct; Look Outside to Verify Reports

By Nina Youngstrom

Hotline calls and other tips are the best way to uncover potential violations inside organizations, but getting the full picture often requires documents and other evidence that only can be found outside the organization, one expert says.

“The best line of defense for organizations who want to control, prevent and resolve misconduct are your own employees and third parties supporting your organization,” said former federal prosecutor Jeffrey Klink, CEO of Klink in Pittsburgh, Pennsylvania.

Multiple hotline calls and other complaints exposed corruption by a vendor procurement employee at one Pennsylvania company. The woman was having an affair with a married vendor, from whom she solicited kickbacks. “It was a classic kickback scheme where the vendor inflated the prices on the goods being sold, the employee approved the inflated invoices, and when the vendor got paid, he kicked back some of the money to the employee,” Klink said. Hotline calls came in about the employee’s relationship with the vendor, but there were other signs that something was amiss. The CEO wanted to know who was driving a nicer car than him, and it turned out to be the vendor procurement employee, who also left copies of her healthy bank statements on the Xerox machine.

When Klink was hired to investigate, he found purchasing improprieties in records and employee interviews, but convinced the company not to fire the woman yet. He wanted her in the dark while he conducted a broader investigation. After searching property records, Klink discovered the vendor procurement employee and vendor had purchased a house on Philadelphia’s expensive Main Line, and that while on a supposed vacation to the Jersey Shore, she was actually in China forming an apparel company with the vendor. And although she had deleted emails with her vendor boyfriend, a forensic audit retrieved them. When confronted, the woman denied the misconduct until presented with the evidence.

Although the company declined to refer her to law enforcement, it fired her and recovered $4 million under its fidelity/crime insurance policy, which insures against employee or vendor misconduct, said Klink, who spoke at a March 12 webinar sponsored by the Society of Corporate Compliance and Ethics. “It’s illustrative of what you might do when thinking outside the box,” he noted.

As was the case here, organizations often refuse to report misconduct to law enforcement because it makes the people in charge look bad, Klink said. They don’t want negative press, and nonprofits worry donors will think twice about their donations if money is siphoned to fraud, “and there’s the same thought process for investors in for-profits,” he explained. “I think sometimes people don’t understand the extent and materiality of fraud” and prefer to resolve it themselves.

Reporting comes in many forms: phone, mail, email, web form, a concern box or in person. Although many sophisticated organizations have hotlines, they may not be used because their importance isn’t effectively communicated. One way to get the message across: put the burden on employees to report suspected misconduct by penalizing failure. For example, the code of conduct could state that they are obligated to say something if they see something, Klink said.

Hotline callers should get feedback or people will stop reporting their concerns. For example, sometimes hotline reports gather dust because of mergers and acquisitions. "If you don't respond, people won't continue to use the hotline," he noted. "We have talked to a lot of people after reports of misconduct. They said, 'I quit sending them because no one responded.'"

Resist the Need for Speed

Klink cautions that compliance officers should resist if they are pressured to resolve hotline complaints quickly. Proper investigations take time. He worked on an investigation of the U.S. subsidiary of a European company after a hotline caller reported that the subsidiary's president had a competing business on the side. The CEO of the parent company said "fire the guy," which left Klink to get to the bottom of the alleged misconduct without being able to interview the terminated executive. "Now we are working on the case, and it's clear suspicions were there, but it would have been helpful if he were suspended instead and we could have interviewed him," Klink said. "We might not, however, have determined the correct total amount of the losses or identified all the wrongdoers. In every case, the best possible source of information is that person or those persons who committed the misconduct. If an organization really wants to understand how a scheme occurred, who was involved, what the total amount of the loss was and what internal controls need to be improved, then it is very useful to interview any and all known participants in the misconduct."

When investigating hotline reports, compliance officers should gather as much information as they can, inside and outside the organization, but restrict the flow of information. "Before you start interviewing lots of folks, do your homework. Read emails and sales contracts and review any static piece of information you can," he advised. But don't limit your preparation to company information because there may be secrets elsewhere (e.g., public databases, physical locations). And like a good trial attorney, know the answers to the questions before you ask them in interviews. That way, you can test people's credibility. "One of the mistakes I have seen when folks are conducting interviews is there is an assumption this is a one-time fraud or limited case of misconduct, but often the opposite is true," Klink said. "In hotline reports, you see the tip of the iceberg. You think one or two employees are involved, but 10 to 12 turn out to be involved."

That was the case with a Chinese business acquired by an American corporation in 2011. The Chinese corporation relied heavily on vendors. After the acquisition, upwards of 100 hotline reports came in about supervisors taking kickbacks from vendors, which turned out to be shell companies owned by the supervisors, although that became apparent later, as the hotline calls became more specific and an investigation got underway. At first, though, internal auditors from the American corporate office were sent to China to evaluate the hotline calls and found no problems. Then an external audit firm came in and found no evidence of wrongdoing.

Finally, Klink was asked to review the hotline allegations, and he tried something different than relying on company papers. He limited his investigation to the largest 20 vendors supposedly engaged in misconduct and made site visits. "What we found were vacant lots and alleyways and studio apartments," he said. "They were shell companies, and the management in China had controlling interests in all these vendors and shared the profits. And we found vendors and managers were paying large bribes to government officials. The accuracy of the hotline reports made were very telling." Klink also interviewed legitimate vendors who were unable to win bids with the Chinese subsidiary. The U.S. company had been defrauded of $3 billion, he said, and it may not have been uncovered without thinking outside the box when investigating allegations in hotline calls.

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