



DRM, Inc.

Timber Executive Guilty in Sawmill Fraud at Barnesville

June 2010

On August 27, 2003, a federal jury in Atlanta found John F. Thompson III guilty of taking payments for timber loads that never existed. The fraud ran for almost ten years and totaled approximately \$7.5M in losses from both P&G and Weyerhaeuser. Thompson carried out the fraud with the help of Annie Bailey, the scale house operator at the Barnesville mill, who provided false tickets for the phantom shipments. Ms. Bailey was indicted in November of 2002. Both subjects were indicted for conspiracy, mail fraud and money laundering. Bailey pled guilty to two counts of Tax Evasion in exchange for her cooperation in the case against Thompson.



Security Breach/Damage:

The Barnesville facility was first owned by P&G and then sold to Weyerhaeuser in 1992. Thompson met Bailey in 1987 during a P&G program designed to familiarize suppliers with the Barnesville operation. Thompson was the owner of Thompson Timber Company and supplied round wood to the Barnesville sawmill and other forest product facilities. Thompson Timber had its own timber supplies and logging equipment and also acted as a broker for other independent loggers and haulers.

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guaranteed acceptance of a specific minimum number of truck loads of logs to the mill per week. In addition, trucks hauling for Thompson would have their tare weights averaged, so that during sawmill busy periods, the trucks would not have to physically weigh-out empty, their tare average could be used - a time and money saving benefit to any supplier.

Bailey was employed as a weigh scale operator for P&G since it's startup in 1982. She was divorced in 1986, making \$7.25 per hour and living in a house trailer. The Barnesville sawmill was operating two shifts per day and taking all the wood that suppliers could deliver - 100 or more truckloads per day.

The stage was set...

At first Thompson supplied Bailey with blank trip tickets and information necessary to make false scale tickets for which he would receive payments. Bailey was paid \$50 for each false scale ticket. The exchange took place in a convenience store near the raw materials entrance to the mill.

In 1988, the arrangement changed. Bailey created LB Howard Logging Company. Bailey would telephone Thompson's office weekly with a gross total (cords) of the LB Howard wood supposedly delivered to Barnesville and follow the call up with copies of the falsely fabricated scale tickets mailed to Thompson's office. Thompson Timber would then create a "Settlement Sheet" for LB Howard Logging that had only a gross number of cords delivered and "x"\$ per cord and the total dollars. There was no itemized list of individual loads. A copy of this Settlement Sheet and a check was express mailed to LB Howard Logging at Bailey's home address. Bailey would deposit the check in an account she set up for the fake LB Howard Logging Company.

In late 1999, the Barnesville mill was owned by Weyerhaeuser Corporation and an IRS agent contacted its Regional Security Manager and requested specific scale ticket information from the Barnesville mill. Payment was made by Weyerhaeuser to this supplier, who in turn paid Thompson. The deception continued to multiply into other schemes. Some tickets indicated that they were for "Special Price contracts making the scale tickets for these contracts a higher price-per-ton than regular wood. Even actual wood that was delivered to the mill was attributed to other counties than where it was harvested, in effect capturing the higher zone prices. If quota's interfered with their scheme then they would submit false scale tickets under another company's quota.

In all, 1661 bogus scale tickets were created by Bailey between January

deliveries from Thompson comprised 3.4%-4.9% of the total wood delivered to Barnesville. As stated, both were found guilty and sentenced in federal courts. Thompson was sentenced to 5 years and 11 months in federal prison, ordered to pay restitution of 6.7 million dollars, ordered to serve 100 hours of community service and 3 years of supervised release after serving the prison term. Bailey was sentenced to 1 year and 10 months, ordered to pay restitution of 6.7 million dollars, ordered to serve 100 hours of community service and 3 years of supervised release after serving the prison term.

Recognition

The IRS was alerted to the fraud from an anonymous tip and their investigation uncovered the fraud operation. When the IRS knocked on their door in 1999, Weyerhaeuser was surprised. There was no apparent reason to believe that it had been a fraud victim - especially at the levels indicated in the indictment at the end of the investigation. There were inventory issues, but they were explained by other parts of the operation and didn't seem as out of the ordinary. Bailey was a good employee. She left the company for health reasons (following a lightning strike on the scale house). There was nothing to raise suspicion about her departure. There was a valid contract in place with Thompson Timber Company and there were built-in software controls to prevent and identify (red flag) this type of fraud.

How Could This Happen?

Environment - During this time there was a high volume of truck traffic in and out of the mill. There was a single scale bed for both in-bound and out-bound traffic which caused further traffic delays for the scales and facilitated the need to use averaged tare weights during busy times.

Security - There were no CCTV cameras in place to observe and record scale activity and the scalers were physically separated from the mill, administrative offices and other employees of the mill.

Business Conduct - Hourly scale operators didn't have an annual Business Conduct Certification.

Other Factors - There were a variety of other factors that should have raised red flags but went unnoticed:

- (a) Bailey's boyfriend had a trucking firm that utilized flatbed trailers and was allowed to be a contract hauler for finished Barnesville products. This provided a ready source of fictional weight tickets for Bailey.
- (b) Computer protocols regarding user sign-in and sign-out were not followed. This made it more difficult to determine who was operating the scales.
- (c) The extravagant lifestyle of Bailey (big house, luxury cars and high-end

legitimate company.

(e) Bailey helped confuse the inventory issues by occasionally "painting" a second stem, on in-coming log trucks. Since the painted ends are used to determine the number of truck loads in the deck, painting an extra stem covered some of the false tickets.

(f) Procedures, such as tare weight averaging, allowed for completion of bogus scale tickets without actually weighing an empty truck. A majority of the fake tickets were believed to have been made through the use of an empty in-bound truck as opposed to using the tare weight.

Recommendations

1. Require annual employee business conduct certification for all employees involved in raw materials procurement and supply.
2. Include Business Conduct guidelines for suppliers, vendors and contractors and review their participation annually (include in contract)
3. Update computer user protocols to facilitate user/operator identification.
4. Test audit scale operations regularly to ensure all business controls are in place and working appropriately.
5. When possible single platform scales operations should be avoided. Two scaling platforms are recommended. Adding electronic video recording of all scale transactions is highly recommended.
6. Once cameras are in place, randomly audit the footage for abnormalities.
7. Utilize sequentially numbered inventory tags on each load for inventory control.

DRM, Inc.

With over 21 years' experience in the forest products industry, Dendro Resource Management, Inc. (DRM) is a leader in timber audit services. DRM is committed to supporting the integrity of the forest industry by providing independent analysis and recommendations regarding internal controls as well as actively detecting and documenting theft and fraud incidents.

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