

Building a solid Exception Strategy

As Investigators we are trained to conduct research in the following way:

- Look at everything (Sift through all the data)
- Determine Analysis of Methods of Operations
- Leave no stone unturned

“Learning is about more than simply acquiring new knowledge and insights; it is also crucial to unlearn old knowledge that has outlived its relevance. Thus, forgetting is probably at least as important as learning.”

- Gary Ryan Blair

Exception: \ik-`sep-shən\

The act of excepting or excluding; **exclusion**; restriction by taking out something which would otherwise be included, as in a class, statement, rule.

An action that is not part of ordinary operations or standards

Exception Based Reporting (EBR) is often referred to as an application LP uses to identify extreme POS activity; however, exception strategies can be used in any type of reporting or with any data by taking the Top “X” or Bottom “X” of what is measured.

Exception Reporting is a key way to identify process breakdowns, dishonesty, and methods for improvement. Implementing the use of exceptions will help reduce risk areas and provide understanding.

Exception Based Reporting:

Purpose:

- Identify anomalies and non-compliance
- Report and improve performance
- Isolate data into manageable information

Exceptions require criteria:

- Perform single factor analysis
- Perform combined factors analysis
- Establish threshold levels

- **Actively Review Exceptions:**
 - Create action plans with the objective in mind (Training, Investigating, Awareness, etc...)
 - Data should drive action/decisions
- **Continue to learn from your data:**
 - Research new factors that impact exceptions
 - Re-engineer cases that didn't hit exceptions (why were they missed?)
 - Re-evaluate exception criteria

Develop a standard review process and timeline for data:

- **Weekly** (Best time frame for setting exceptions)
 - Usu. transactional data as it is more consistent for hrs. worked
 - **Exceptions** build history and trends of activity by target data
- **Monthly**
 - Purchase history, Paid outs, or Sales Reducing Activity
 - Identifies training issues/Compliance
- **90-day**
 - credit cards, Over and Shorts, cycle counts
 - Needs extended data aggregates to determine patterns/trends
- **Annual**
 - Inventory levels, Sales, Turnover, Shrink

There are three basic steps to the strategy of building successful exceptions:

- 1) identify a relationship or covariance between variables (one variable is related, increases or decreases in value, in some predictable manner along with increases or decreases in the other variable)
- 2) identify the time sequence of the relationship. Which variable is independent or predictor variable “x” and which is the outcome or dependent variable “y”
- 3) exclude rival causal factors – or eliminate other variables that could conceivably legitimize the occurrence.

Group transactions by predictive values

- Refund Fraud, Sweet-Hearting (Trans < \$1), etc...
- Post-Void Followed by No-Sale

Determine Predictivity:

- Summed across the group in a given subset
 - i.e. flagging exceptions for previously hitting exceptions
- Learning from Exception history – patterns can be identified:
 - Continuous decrease in value each week – Training Issue?
 - Continuous increase in value each week – Greed?
 - Little to no movement in value – Re-evaluate to determine why?
 - Sporadic weeks hitting the exceptions?
 - are there common weeks identified? (first/last weeks – monthly bills)
 - are certain weeks identified? (correlate with scheduling issues, sales, promotions, etc..)

Determine false-positive ratio

- Determine the number of exceptions that did not identify the objective
- Determine what unique factors they have that can be further excluded from the exception criteria

Look for optimized predictors

- Can there be other factors that contribute to the results?
- Are there common factors that lead to specific results?

Causality

“The ultimate purpose of scientific investigation is to isolate, define, and explain the relationship between key variables in order to predict and understand the underlying nature of reality.”

Exception Causation

- A question that often comes up is are exceptions the result of something or do exceptions cause something else to occur?
 - Example: A (Poor POS Controls), B (Employee Dishonesty), C (Shrink); If $A = B$ and $B = C$, then $A = C$, right?
 - We have all heard this in school; however, poor POS controls (A) alone doesn't necessary lead to Employee Dishonesty (B) there are usually other factors. And we all know that Employee dishonesty is **not** the only contributing factor to shrink (C).

Loss Prevention is the concept of impacting that which is attempting to be controlled or eliminated. Exceptions determine if the actions, tools, tactics and strategies being used are having an impact.

Prediction is understanding exceptions enough to turn them into preventative indicators....

Moving away from the “needle in the haystack” approach, exceptions will:

- Translate data into information
- Target risk factors specific to your company (Customized)
- Automate & Prioritize Research (z-score, rank score, or composite score)
- Track for previous hits (building predictive patterns)

Key points to remember:

- Exceptions are queries that are created from ***specific criteria and thresholds*** and are usually set up to report weekly.
- Exceptions quite often strip out other elements of the transactions and only present what is targeted, so don't forget to review the entire transaction to get the whole picture.
- Never forget to ***customize*** criteria for the company culture
- Not every exception will have the same results – watch for false positives, re-evaluate factors, and build intelligence from past exceptions.

When POS exception activity is clearly identified you will discover one of two things:

- 1) The activity **is** the cause of the loss, or...
- 2) The activity **contributes** to a loss.

The difference is the type and amount of loss that is acceptable as the cost of doing business. Identify which of your exceptions target these areas:

- Pure loss (shrink)
- Margin Loss/Business Abuse
- Training and Systemic errors

The same analytics that successfully identify fraud through POS, can recognize inefficiencies in operations, inventory, logistics, compliance, etc... exceptions can be applied in any type of reporting.

Think of the 20/80 rule - it is nothing more than exceptions!

- The few best or worst of the whole are the focus...
- Exceptions can be positive or negative
- Emphasize the best performers or locations as examples of success
- Negative exceptions need behavioral course corrections made to curb any financial impacts.

Questions?