Financial Transactions and Fraud Schemes

Asset Misappropriation: Fraudulent Disbursements
Fraudulent Disbursement Schemes

- Register disbursement schemes
- Check tampering schemes
- Payroll schemes
- Billing schemes
- Expense reimbursement schemes
Register Disbursement Schemes

- False Refunds
  - Fictitious Refunds
  - Credit Card Refunds
- False Voids
Register Disbursement Scheme Red Flags

- Register employee has the authority to void his own transactions.
- Personal checks from the cashier are found in his register.
- There are gaps in the sequence of transactions on the register log.
- An excessive number of refunds, voids, or no-sales are on the register log.
- There are multiple refunds or voids for amounts just under the review limit.
Check Tampering

- Perpetrator physically prepares the fraudulent check
- Forged Maker Schemes
  - Employee misappropriates a check and fraudulently affixes the signature of an authorized maker
- Forged Endorsement Schemes
  - Intercepts check and forges or adds second endorsement
- Altered Payee Schemes
  - Changes whom the check is payable to
- Authorized Maker Schemes
  - Has signature authority but writes check for improper purpose
Check Tampering

- Red Flags
  - Missing checks or large gaps in the check register
  - Checks payable to employees
  - Payee addresses that match employee addresses
  - Duplicate or counterfeit checks

- Prevention
  - Checks mailed immediately after signing
  - Bank reconciliations not made by signatories
  - Establish maximum amounts with bank
  - Use positive pay
Electronic Payments

- Once the fraudulent payment has been made, the employee must cover his tracks.
- Lack of physical evidence and forged signatures can make concealment of fraudulent electronic payments less challenging than other check tampering schemes.
Electronic Payments

- Prevention
  - Separation of duties
  - Segregate bank accounts to maintain better control
  - ACH blocks
  - ACH filters
  - Positive pay
Billing Schemes

- Three principal types:
  - False invoicing via shell companies
  - False invoicing via nonaccomplice vendors
  - Personal purchases made with company funds
Invoicing Via Shell Companies

- Forming a shell company
- Submitting false invoices
- Purchase of services rather than goods
- Pass-through schemes
Invoicing Via Nonaccomplice Vendors

- Pay-and-return schemes
  - Employees intentionally mishandle payments that are owed to legitimate vendors
  - One way to do this is to purposely double-pay an invoice
Personal Purchases with Company Funds

- Personal purchases through false invoicing
- Personal purchases on credit cards or other company accounts
Prevention of Billing Schemes

- Segregation of duties
  - Purchasing should be separate from payment
- Hotlines
- Competitive bidding
Payroll Fraud Schemes

- Ghost employee schemes
  - Ghost added to the payroll.
  - Timekeeping and wage rate information must be collected.
  - Payment must be issued to the ghost.
  - The check must be delivered to the perpetrator or an accomplice.

- Falsified hours and salary
  - Most common method is the overpayment of wages.
  - Hourly employees falsify:
    - Number of hours worked
    - Rate of pay
Payroll Fraud Detection

- Analysis of Deductions from Payroll Checks
  - Ghosts will often have no withholding taxes, insurance, or other deductions
- Compare employee names, addresses, identification numbers, and bank account numbers for duplication
- Compare employee payroll records to human resources employee files to ensure all individuals receiving payroll checks are employees
- Examine payroll checks for dual endorsements
Expense Reimbursement Schemes

- Mischaracterized Expense Reimbursements
  - Which expenses a company will pay for depends to an extent upon policy, but in general, business-related travel, lodging, and meals are reimbursed.
  - One of the most basic expense reimbursement schemes is perpetrated by simply requesting reimbursement for a personal expense by claiming that the expense is business related.
Expense Reimbursement Schemes

- Overstated Expense Reimbursements
  - Altered receipts
- Fictitious Expense Reimbursements
  - Producing fictitious receipts
- Multiple Reimbursements
- Detection
  - Analysis of expense accounts—historical comparison; compare actual and budgeted expenses
- Prevention
  - Require explanation of the expense and time period
  - Require original paper receipts
Sample Prep Question

1. Baker, the managing partner in a small law firm, is the authorized signer on all company checks. When his personal phone bill arrived last month, Baker prepared and signed a company check to pay the bill. He did not disclose this payment to his partner. Baker committed:

A. A forged maker scheme
B. A false billing scheme
C. An authorized maker scheme
D. None of the above
Correct Answer: C

- An authorized maker scheme is a type of check tampering fraud in which an employee with signature authority on a company account writes fraudulent checks for his own benefit and signs his own name as the maker. The most common example occurs when a majority owner or sole shareholder uses his company to pay personal expenses directly out of company accounts.
Sample Prep Question

2. Which of the following is NOT a type of expense reimbursement scheme?

A. Mischaracterized expenses
B. Overstated expenses
C. Multiple reimbursements
D. Skimmed reimbursements
Correct Answer: D

- The four types of expense reimbursement schemes are:
  - Mischaracterized expenses
  - Overstated expenses
  - Fictitious expenses
  - Multiple reimbursements
Sample Prep Question

3. A ________________ is a fictitious entity created for the sole purpose of committing fraud.

A. Charter company
B. Shell company
C. Nonaccomplice vendor
D. Fraudulent invoice
Correct Answer: B

- Shell companies are fictitious entities created for the sole purpose of committing fraud. They may be nothing more than a fabricated name and address that an employee uses to collect disbursements from false billings. However, since the checks received are made out in the name of the shell company, the perpetrator normally also sets up a bank account in the shell company’s name.
Sample Prep Question

4. Zach was booking travel arrangements for a business trip. He purchased an airline ticket online using his own funds and obtained a receipt for the ticket via email. Using photo-editing software, Zach changed the ticket price from $530 to $680 on the electronic receipt and submitted it to his employer for reimbursement. This is an example of what type of fraud scheme?

A. Personal purchases with company funds
B. Mischaracterized expense scheme
C. Multiple reimbursement scheme
D. Overstated expense scheme
Correct Answer: D

- Instead of seeking reimbursement for personal expenses, some employees overstate the cost of actual business expenses. The most fundamental example of an overstated expense reimbursement scheme occurs when an employee alters a receipt or other supporting documentation to reflect a higher cost than what he actually paid.
Financial Transactions and Fraud Schemes

Check and Credit Card Fraud
Check Fraud

- **Prevention:**
  - Education
  - Strict check acceptance policy
  - Ask for valid identification

- **Counterfeiting checks**
  - Requires little capital to perpetrate

- **Check theft**
  - Stolen canceled checks and statements
  - Check washing
    - Using acid-based chemicals to alter checks
  - Stolen check stock
Check Fraud Schemes

- **Check Kiting**
  - Money “deposited” from account to account, though it never exists
  - Takes advantage of “float” period

- **Check Fraud Rings**
  - Organized crime rings are the cause of most check fraud
  - Equipment cheap and easy to obtain

- **Investigation Red Flags**
  - Frequent deposits and checks in same amount, round numbers
  - Frequent ATM balance inquiries
  - Checks issued to individuals for large, even amounts
  - No supporting documentation
  - Cash withdrawal with deposit checks drawn on another bank
Credit Card Schemes

- Unauthorized Use of a Lost or Stolen Card
- Organized Crime Rings
- Stolen Card Numbers
- Counterfeit Cards
  - Blank cards known as “blank plastic”
  - Hologram most difficult thing to reproduce
- Skimming
  - Card information captured through a skimmer or wedge
- Account Takeover
Prevention and Detection

- Makes several small purchases to stay under the floor limit, or asks what the floor limit is
- Does not ask questions on major purchases
- Signs the sales draft slowly or awkwardly
- Charges expensive items on a newly valid credit card
- Cannot provide photo identification when asked
- Rushes the merchant or teller
- Purchases a large item, such as a television, and insists on taking it at the time, even when delivery is included in the price
Smart Cards

- Generally more secure than traditional magnetic stripe credit cards.
- A *smart card* is a plastic card, the size of a credit card, embedded with a microchip.
- Identifies the user through encrypted information on the chip and must be inserted into a card reader connected to the credit provider’s network.
Electronic Bill Payment

Types of fraud:
- Fraudster provides biller with someone else’s bank info
- Hacker obtains usernames and passwords
- Employee providing EBPP services directs transfers from customers’ accounts

Prevention:
- Send a welcome letter to address on application
- If access device is stolen, cancel card, PIN
- Mail PINs separately
- Separate responsibilities of bank employees
Sample Prep Question

1. Which of the following is a potential indicator of check fraud?

A. Frequent account balance inquiries at ATMs
B. Unavailable supporting documentation for checks
C. Cash withdrawal when depositing a check made from another bank
D. All of the above
Correct Answer: D

- During a check fraud investigation, the fraud examiner should look for the following red flags, among others:
  - Frequent deposits and checks in the same amounts, in round numbers, or with checks repeatedly drawn on a different bank
  - Frequent ATM account balance inquiries
  - Voided checks are not retained
  - Checks are issued to individuals for large, even dollar amounts
  - Supporting documentation for checks is not available or has been prematurely destroyed
  - Cash withdrawal with deposit checks drawn on another bank
2. Which of the following is NOT a red flag of a fraudulent credit card transaction?

A. A customer insists on taking a large item home even when delivery is included.
B. A customer charges many expensive items to a newly valid card.
C. A customer asks the cashier to take his time and not to hurry.
D. A customer makes several small purchase with separate transactions.
Correct Answer: C

- Tellers and merchants should be advised to be alert for the customer who:
  - Makes several small purchases to stay under the floor limit, or asks what the floor limit is
  - Signs the sales draft slowly or awkwardly
  - Charges expensive items on a newly valid credit card
  - Cannot provide a photo identification when asked
  - Rushes the merchant or teller
  - Purchases a large item, such as a television, and insists on taking it at the time, even when delivery is included in the price