# Forensic Accounting

## Lessons from the World of Fraudsters

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# Agenda

- Check Tampering
- Local examples
- The perfect crime
- How to wash a check (demo)
- Some conclusions about check fraud
- Money laundering – huge problem
- Short exercise in laundering money
- Local examples in Kansas
- How to launder money

# Detecting Fraud

***Forensic accounting*** **is about detecting fraud in the accounting records.**

**However, to suggest that forensic accounting is *limited* to the accounting records would vastly understate its role.**

# Detecting Fraud

**Think of forensic accounting as building a mosaic or perhaps the dot-to-dot games you played as a youth.**

**It's about using clues, patterns, hunches, accounting activities, people skills, trace evidence, etc. to build a case that will eventually go to court.**

**Evidence!**

# Detecting Fraud

What is at the core of every fraud?

Occupational fraud and financial statement fraud involve the same basic component.

**Deception!**

# Check Tampering

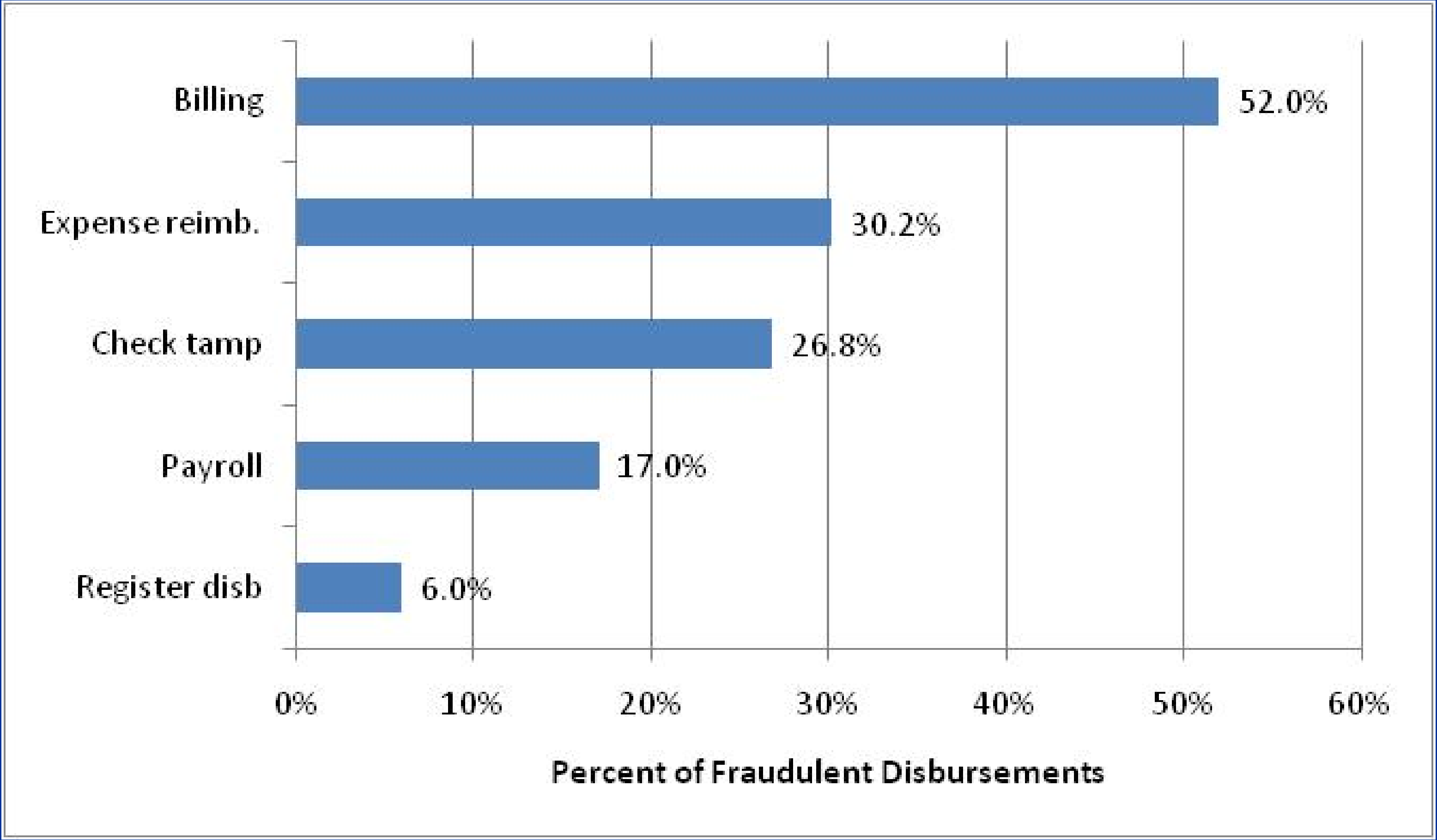
- Forged Maker
- Forged Endorsement
- Altered Payee
- Concealed Checks
- Authorized Maker

Check Washing

# What is Check Tampering?

- Form of Fraudulent Disbursement
- Employee does one of two things:
  - Prepares a fraudulent check for own benefit
  - Converts a check intended for someone else

# Frequency of Disbursements

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# Median Loss of Fraudulent Disbursements

# Check Tampering Schemes

- **Perpetrator physically prepares the fraudulent check**
- **Must have:**
  - **Access to checks**
  - **Access to bank statements**
  - **Ability to forge signatures or alter other information on the check**

# 1 - Forged Maker Schemes

- Perp forges name of authorized signer
- Obtaining a blank check:
  - Perp usually has access to blank checks
    - Bookkeeper, a/p clerk, office manager, etc.
  - Checks not secured
  - Perp wrongly obtains key, combination, password to gain access
  - Voided checks not destroyed
  - Print counterfeit company checks

# Forged Maker Schemes

To whom is the check made payable?

- To the perp
- To an accomplice
- To “cash”
- To legitimate vendors (purchasing personal items)
- To fictitious person or entity

# Obtaining the Check

- **Employees having access to company checks**
  - A/P clerks, office managers, bookkeeper
- **Employees lacking access to company checks**
  - Checks poorly guarded
- **Producing counterfeit checks**

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# The Perfect Crime?

- Let’s see if we could devise the perfect crime – one in which there is a big payoff and where the likelihood of being caught is minimal…

- Interested?

Source: FBI Bulletin

# Steps in the Long Con

1) Purchase versa-check
2) Find a mark
3) Establish a shell company
4) Open a bank account in a small town
5) Use social engineering to get bank officials to like you
6) Move checks from one bank to another for several months
7) Strike and leave

# Safeguarding the Check Stock

- Maintained under lock and key
- Access limited to those with check preparation duties
- Boxes of blank checks should be sealed with security tape
- Periodically check the security of unused checks
- Voided check should be promptly destroyed

# Stolen Checks - Countermeasures

- Watermark paper supplied by company independent of check printer
- Security threads in check stock
- Rotate check printers and/or check stock (so counterfeits will stand out)
- Use positive pay banking controls

# Stolen Checks - Countermeasures

- Keep blank check stock secured
- Seal boxes of blank checks with security tape
- Investigate out-of-sequence or duplicate check numbers on bank statement (indicates stolen or counterfeit check stock)
- Promptly destroy any voided checks

# Forging the Signature

Free-hand forgery

- May not need to be particularly accurate

Photocopied forgeries

- Photocopies are made of legitimate signatures and fixed to the check

Automatic check-signing instruments

- Produce perfect forgeries

# Forged Signatures - Countermeasures

- Strictly limit access to signature stamps
- Use distinctive ink for check signing
- Have authorized check signers verify their signatures on canceled checks
- Investigate nsf checks or out of balance conditions in checking account

# Preventing and Detecting Forged Maker Schemes

- Safeguard blank check stock
- Establish rules for custody of checks prepared but not signed
- Separate of check preparer and check signers
- Rotate authorized check signers
- Limit access to signature stamps

# Forged Maker Schemes

Forging the signature

- Free-hand forgery
- Photocopy legitimate signature onto check
- Signature stamps
- Computer-generated signatures - watch for plates!

# 2 - Forged Endorsement Schemes

- Employee intercepts a company check intended for a third party
- Signs the third party's name on the endorsement line of the check

# Forged Endorsement Schemes

Intercepting the check:

- Perp's duties involve handling signed checks
- Signed company checks not secured
- Checks returned to company (incorrect address)
- Alter delivery address – check mailed to perp

# Intercepted Checks - Countermeasures

- Separate functions of cutting, signing, and delivering checks
- Surveillance cameras in mailroom
- Investigate customer complaints that payments not received
- Investigate any returned check with a dual endorsement
- Periodically lodge "test" checks in payables system and follow their trail

# 3 - Altered Payee Schemes

- Employee (or outside perp) <u>intercepts</u> a company check intended for a third party
- Payee designation is <u>altered</u> so the check can be converted
- Less chance of discovery unless canceled checks are reviewed during reconciliation

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# Flagging


**One of the most dangerous activities concerning check fraud and I/D theft.**
**What is it?**

# Check Fraud Ring

Oskaloosa, Kansas

Osceola, Missouri

# Altered Payee Schemes

Checks *not* prepared by perpetrator:

- Check washing
- White-out payee name
- "Tacking On" (I.R.S. becomes I. R. Stevens)

What solution is good for check washing?

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# Altered Payee Schemes

Checks prepared by the perpetrator

- Perp obtains signatures on blank checks (perp highly trusted)
- Check typed or written in ***erasable ink***
  - Perp gets authorized person to sign check
  - Signed check given to perp to mail
  - Change payee and/or amount
  - When cashed check returned with bank statement, perp restores original name, amount

# Altered Payees – Countermeasures

- Use of permanent ink on all checks
- Segregate check preparation from delivery and bank statement reconciliation
- Use carbon copy checks (even if check is altered, copy will have true payee, amount)
- Use computer-generated checks
- Consider EFT in place of checks, where practical

# Altering Checks Prepared by the Fraudster



## Erasable ink

- Erasing typewriters
- Erasable pens
- Pencils

## Blank checks

- Authorized signer signs a check left blank to be filled in by the fraudster

# Preventing and Detecting Altered Company Checks

- Separation of duties of the check writing process
  - Check preparation, signing, and delivery
- Separation of duties of the check reconciliation process
  - Check preparation and check reconciliation
- Check the canceled check against the entry in the books
- Consider using carbon copy checks to check against canceled checks for discrepancies

# 4 - Concealed Check Schemes

It has been reported that employees are working harder than ever – doing more with less people.  We hear that all the time.

So what does that have to do with check fraud #4 – concealed check fraud?

**What do we, experienced auditors, know about *trust* and *controls*?**

# 4 - Concealed Check Schemes

- Employee prepares a fraudulent check and submits it along with legitimate checks
- Check is payable to the employee, accomplice, a fictitious person, or fictitious business
- Occurs when checks are signed without proper review or reviewer is busy
- In many cases, only the signature line is exposed and the payee is concealed

**Is this easy, or what?**

# Concealed Check Schemes

- Very blatant, not very common (?)
- Perp prepares check payable to self
- Gives check to authorized signer along with stack of legitimate checks
- Check gets signed; signer not paying attention, trusts perp.

# 5 - Authorized Maker Schemes

- Employee with signature authority writes a fraudulent check
- Overriding controls through intimidation
  - High level managers make employees afraid to question suspicious transactions
  - Can happen when ownership is absent or inattentive
- Poor controls
  - Failure to closely monitor accounts
  - Lack of separation of duties

# The Accounting Entry for Fraud

## The “crooked bookkeeper”

| Cash | | Expense | |
|---|---|---|---|
| | 10,000 | 10,000 | |

In this scheme the fraudster could use either a fictitious company name and cash the check at a bank where s/he has an account or use a “void” check and use his or her own name!

# Authorized Maker Schemes – Countermeasures

- Require dual signatures over threshold amount
- Confirm checks to current vendor list
- Spot-check cancelled checks for support
- Look for lifestyle changes in authorized signers.

# Preventing and Detecting Check Tampering by Authorized Makers

- Difficult to detect because check signer is relied on to serve as a control
- Separate the duties of the check writing function
  - Check preparer and check signer
  - Check signers should not have access to blank checks
- Require dual signatures for disbursements over a certain amount
- Maintain up-to-date vendor lists and confirm all disbursements to the lists, scrutinizing checks to unknown vendors

# Concealing Check Tampering

- Forged endorsement schemes and altered payee schemes creates a problem for the fraudster because the checks are intended for a legitimate recipient who will complain if a payment isn't received

- An investigation could be triggered and the fraud discovered

# Concealing Check Tampering

Fraudster reconciling the bank statement

- Fraudulent check can be removed
- Doctor the bank statement
- Code it as “void” or not include it in the disbursements journal

Re-alteration of checks

- Check is changed back to the rightful payee when returned from the bank
- Re-altered checks will match the names of the legitimate payees listed in the disbursements journal

# Concealing Check Tampering

## Falsifying the disbursements journal

- Check made payable to the perpetrator but a different person is listed as the payee in the books
- Amount of the check can also be falsified in the disbursements journal
- Existing accounts that are rarely reviewed or are very active are preferred

# Concealing Check Tampering

## Reissuing intercepted checks

- New checks are issued to replace the ones that the vendor did not received
- The original invoice is changed in a manner that avoids a duplicate check for new check
- New check issued and a stop payment is supposed to have been made

## Bogus supporting documents

- Fake support is needed to support the check
- False payment vouchers, invoices, purchase orders, receiving reports are submitted

# Concealing Check Tampering

If perp reconciles the bank statement:

- Code fraudulent check “void”
- When statement arrives, destroy bogus checks
- Force totals on reconciliation (add wrong)

If payee/amount were altered:

- Re-alter cancelled checks to match postings

# Concealing Check Tampering

- Enter false info in disbursements journal
- Code checks to very active or dormant accounts
- If check to legitimate payee was intercepted, perp may re-issue check so payee doesn't complain
- Create bogus support for check

# General Check Tampering Red Flags

- Excessive number of voided checks
- Missing checks
- Non-payroll checks payable to employees
- Altered or dual endorsements on returned checks
- Alterations to payee, amount on returned checks
- Questionable payees or payee addresses
- Duplicate or out-of-sequence check numbers

# Check Tampering Controls

Separate the following duties

- Check cutting and posting
- Check signing
- Check delivery
- Bank statement reconciliation

Require proper support for all checks

Mail checks immediately after signing

# Check Tampering Controls

- Keep accounts payable records secure from tampering
- Have bank statements delivered, unopened, to two or more independent employees
- Bank statements reconciled by more than one person
- Periodically rotate personnel who handle and code checks

# Check Tampering Controls

Bank-Assisted Controls

- Establish maximum dollar limits for checks drawn on accounts
- Use positive pay system

Purchase company checks from reputable producers

# Money Laundering

**An effort to take cash derived from an illicit activity and "clean" it through a variety of financial transactions that disguise it origins**

# Lawrence, Kansas

**Emerald Connection**

**Drug trafficking, money laundering, id theft, tax evasion, skimming, and more!**

Police say Monsignor Nunzio Scarano's Vatican bank accounts had been used to transfer millions of dollars in fictitious donations from offshore companies. Police said millions in euros had been seized and that other arrest warrants were issued.

# Session Discussion

You're remodeling an old Victorian home and you've decided to replace the lath and horsehair walls with sheetrock. To your surprise, you find stacks of $100 bills in many of the walls – perhaps over a million dollars in total.

Your life is about to change. What would you do?

# Money Laundering

## Forms of Money Laundering

- Smuggling
- Drug trafficking
- Embezzlement
- Insider trading
- Bribery
- Computer Fraud Schemes

# Money Laundering

## How Do These Steps Work?

**Actually, each "scheme" has its own characteristics. Let's look at one simple one.**

# Offshore accounts

- Launderers move their money to a country where the controls against laundering are weak
- Many people think of the Caribbean but these banks exist all over the place

# Bank Secrecy Laws

- Many countries still have very strict bank secrecy laws

  The country with the most is Panama

- Some launderers have stopped using the major countries because it acts as a red flag
- The best secrecy law is for no one to talk about it on either side of the transaction

# Shell Companies

- Smart launderers will set up accounts in other countries as a corporation rather than as an individual
- This is another factor that disguises the identity of the individual
- As long as they do no real business in the country in which they set up, they can work in complete anonymity and escape all taxes

# Trusts

- These are often used along with offshore corporations
- The assets of the corporation are given to the trust and then immediately to the owner of the trust
- The real owner can maintain anonymity

# Wire Transfers

- These are tools used to transfer the money from one location to another
- Wires have made it much harder for authorities to keep up with the movement of the assets

# Intermediaries

- Many launderers are now using intermediaries such as lawyers
- Lawyers have a client/lawyer confidentiality relationship so they can be valuable if they become involved

# Step 3 - Integration

- This is the process of moving the money from the seemingly legitimate form back into the economy
- At this point, the proceeds can be used for any purpose

# Integration

- Alternative Remittance Systems
  - BMPE
- Directors Fees
- Corporate Loans
- Gambling Proceeds
- Life Insurance Proceeds
- Other

# How Big is the Problem?

- The crime is secretive in nature but there are many different estimates
- The International Monetary Fund has estimated that the problem is 2-5% of worldwide GDP
- Using that estimate along with 1996 statistics, that would mean that between $590 million and $1.5 billion is laundered each year

# Steps in Money Laundering

Placement

- Placing illegally gotten money into the financial system or retail economy

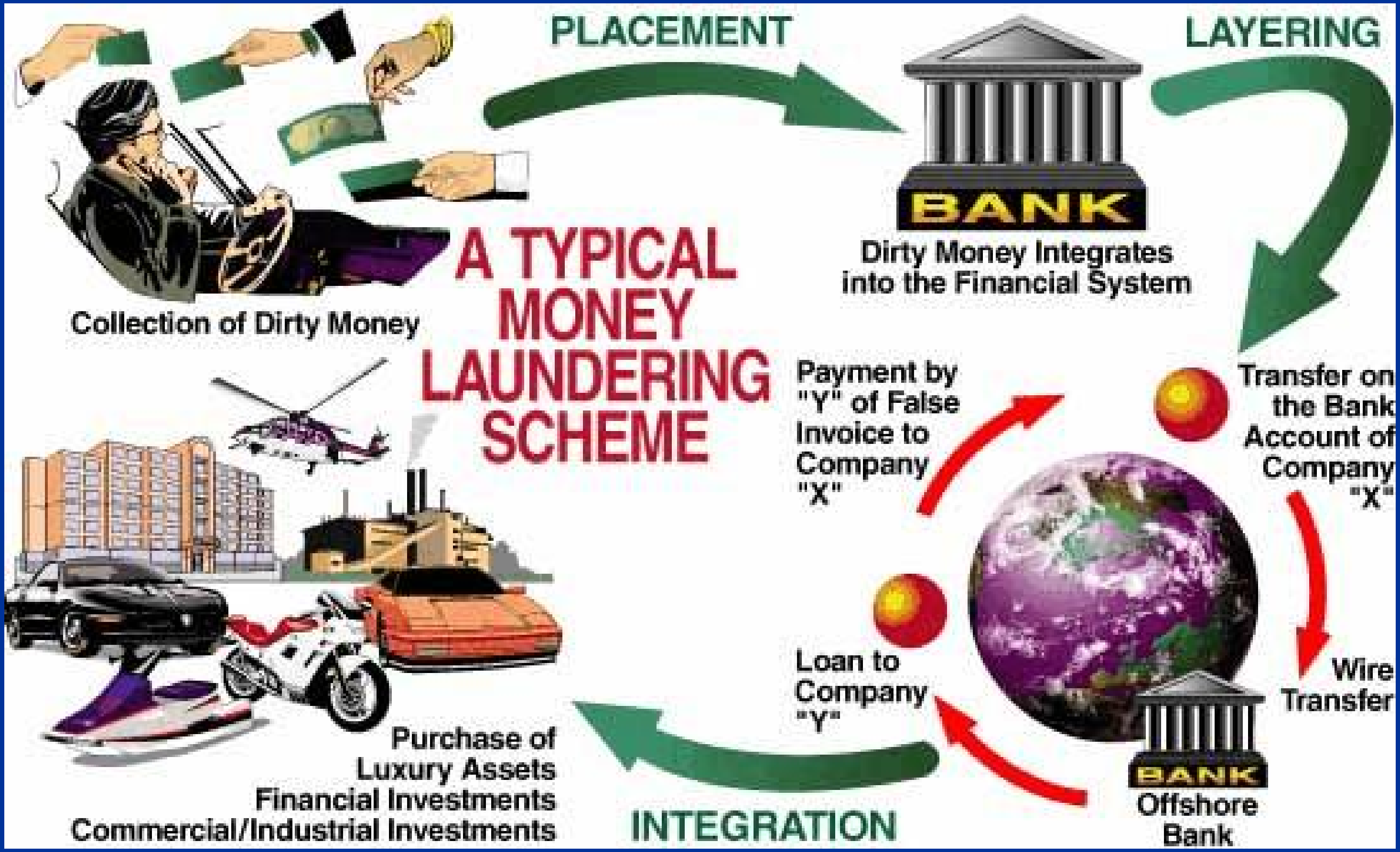
Layering

- series of transactions designed to conceal the origin of the funds

Integration

- process of moving the money from the seemingly legitimate form back into the economy

# Steps in Money Laundering

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# Money Laundering

## Three Basic Steps

Placement

Layering

Integration

# Money Laundering

## Loan Example

| Placement | Layering | Integration |
|---|---|---|
| Embezzle Funds and Deposit in Bank | Makes Loan to Shell Company | Loan Payments are "Washed" |

# Money Laundering

## Art Example

| Purchase of Artwork | Incorporate into Business Structure | Use Proceeds Sell Artwork |
|---|---|---|
| Placement | Layering | Integration |

# Step 1- Placement

This involves a person placing illegally obtained money into the financial system or the retail economy.

# Placement

- Smurfing (Structuring)
- Trade-based
- Collusion with financial institution employees
- Internet Gambling Sites
- Wire Transfers
- Life insurance products
- Foreign Currency transactions
- Smuggling high value items

# Smurfing (Structuring)

This involves a person breaking up a large deposit into many small deposits so they are not flagged by financial institutions

Often involves more than one person

- Usually friends or relatives are involved

# Trade-Based Money Laundering

- This involves using both illicit and licit goods to transfer value
- The invoice is for the incorrect, overstated amount of goods

This allows the fraudster to send more than the required funds overseas to be laundered

# Trade-Based Example

A person in country A over invoices a person in country B, this allows the person in country B with a paper rationale for sending the higher amount to country A

**This transaction looks fine when looking at the documentation**

# Wire Transfers

- This is becoming more and more prevalent
- The advantage is the speed with which wire transfers can move the money

**This can be done several times in very little time, disguising the original origin**

# Internet Sites

- This is one of the newest forms of money laundering
- It is primarily used by people with relatively small amounts to launder
- Easy to use because many of the sites are offshore and do not care where the money comes from

# Placement

- This is not an all-inclusive list but it covers most of the main types
- There are many ways to place money
- As you can see with the addition of internet gambling sites launderers are coming up with new ways every day

# Step 2 - Layering

- A series of transactions designed to conceal the origin of the funds
- This is the most complex and international stage in money laundering

# Layering Tools

- Offshore bank accounts
- Bank secrecy laws
- Shell companies
- Trusts
- Wire transfers
- Intermediaries

# Alternative Remittance Systems

## Black Market Peso Exchange

- Primarily used in connection with Columbian drug money
- The original launderer sells drug-related dollars to BMPE and then they are out
- The “Peso Broker” launders the accumulated money in the US
  - The broker then sells or exchanges these funds to legitimate Columbian importers
  - The funds are used to purchase gold or cigarettes or another trade good

# Director's Fees

- Often a person that sets up an offshore corporation will then pay himself with the illegal money and claim it is a directors fee
- This easily cleans the money because then the individual can

# Corporate Loans

- This is much like directors fees
- The person has the corporation loan him money
- When he pays the money back, the individual can actually send more illegal money offshore because he must “pay back” the money plus interest
- The interest payments are often sent without principal and often consist of illegal money

# Gambling Proceeds

- This type of integration works better for small amounts of money
- A person has their offshore bank wire money to an offshore casino, then the person goes to the casino and takes out the money in the form of chips
- Then gives them to a friend or relative or cashes them back in himself
- The person can declare the winnings when going through customs
- Some casinos have checks against this occurring, especially in the US

# Life Insurance Proceeds

- A person buys an investment-grade policy
- The person then significantly over funds the policy and makes early withdrawals
- Stiff penalties go along with the early withdrawals but the beneficiary of the policy can receive legitimate looking checks or wire transfers

# Other

- There are new ways that spring up each day
- These criminals are usually parts of large organized crime groups and are very sophisticated when it comes to crime

# Who is Fighting this Crime?

- US Department of State
- Financial Action Task Force (FATF)
  - Group primarily charged with establishing anti-money laundering standards around the world
- Interpol
- International Monetary Fund (IMF)
- International Money Laundering Information Network (IMoLIN)- information provider
- US Department of the Treasury
  - Financial Crimes Enforcement Network (FinCen)
- United Nations Office on Drugs and Crime

# Recent Cases

## Columbian Drug Traffickers

- $80 million in movement

- Items used included: international insurance policies, international markets, and financial professionals
- Has resulted in the seizure of $9.5 million in the United States, $1.2 million in Panama, and $20 million in insurance policies in Columbia.

# Recent Cases

- Mississippi HP pulled over a suspicious looking Porsche Boxster and searched the vehicle
- Police found a hidden compartment under the hood filled with wrapped US currency- $1,103,125
- Defendant claimed that he knew about the compartment but not the illegal substance on the way to North Carolina but he did know about the currency inside on the way back to Mexico
  - He gave the car to two unknown Hispanic males in North Carolina and got the car back in three hours
- Porsche was pulled over one day later in El Paso where authorities found 55.6 Kg of Cocaine in the compartment

# Recent Cases

- NYC- 11 jewelers at 7 establishments
- Accepted cash in exchange for gold items that they believed were being smuggled
- Individuals were caught when undercover agents took money in that they said was drug money and received gold items that they said would be smuggled
- Items ranged from gold tools, pellets, trailer hitches, and other auto parts
- Arrest resulted in seizure of 140 Kg of gold ($1.4 million), $1 million in diamonds, and molds that were used to make tools, gold firearms, and vehicle parts

# Recent Cases

- Two New York based art dealers attempted to sell paintings in exchange for “dirty” money, knowing that it was dirty ($4.1 million)
- Unfortunately for the dealers, the person they tried to sell it to was an undercover agent
- They offered to get a buyer overseas to buy the art from the agent as part of the deal and told him that he would be able to easily sell it for 90% of its worth
- The Patriot Act has made money laundering using art more difficult because it requires dealers to report any transaction of over $10,000

# Money Laundering Red Flags

- Evidence of structuring
- Frequent use of night deposits or ATM deposits
- Transactions that have a large number of wire transfers with no apparent reason
- Use of multiple accounts with the same beneficiary
- Transfer of funds from one business to another with no apparent connection
- Cash debits in which deposits in one country are identical to ATM withdrawals in another country

# USA Patriot Act

Enhanced the flow of financial information relevant to money laundering:

1) within the Federal Government

2) between govt and financial institutions

3) 3) between financial institutions

# USA Patriot Act

- Requires all financial institutions to establish anti-money laundering programs, enhanced record keeping, and suspicious act reporting requirements
- Also gives the govt the authority to designate a bank, country, account, etc as a “primary money laundering concern” so that US institutions will have to take specified countermeasures

# Money Laundering

Violations of:

Bank Secrecy Act (1970)

1985 Extended to Casinos

1996 Extended to Tribal Gaming

# Money Laundering

## Good Place to Launder?

Some common examples include:

- Panama
- Cyprus
- Cook Islands
- Marshall Islands
- Philippines
- Russia
- St. Vincent
- Nigeria