WHEN THE ECONOMY DECLINE, ARE YOUR ETHICS FOLLOWING?

WITH ECONOMIC DECLINE, THE INCIDENCE OF INTERNAL FRAUD OFTEN RISES...

IS ON THE EMPLOYEES'

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This is due to a variety of factors, including employees' fear that their jobs may be at risk, along with staff reductions and higher workloads providing opportunities for crimes to go undetected. Employee fraud or asset misappropriation occurs at all levels of employment – from bank executives to tellers, customer service representatives (CSRs), to those in mid-management, usually in the accounting or financial department of the bank.

The first line of defense for bank management is your internal audit team. A walk-through of your internal control procedures can help reduce opportunities for employee fraud.

OTHER FIRST-LINE DEFENSES INCLUDE:

- Perform employee background checks
- Rotate job responsibilities
- Insist on mandatory vacations
- Review your Code of Conduct Policy, Employee Ethics Policy, and Whistleblower Policy with your employees
- Create an environment in which dishonest acts are not tolerated and are punished

COMMON TYPES OF BANK FRAUD

The most common internal bank fraud involves misappropriating cash on hand or the cash account. This crime can be subdivided into three specific types: Skimming; Larceny; and Fraudulent Disbursements.

SKIMMING MAY CONSIST OF:

- Decreasing cash or the repeated out-of-balance condition
- Delayed posting of cash receipts

LARCENY MAY INCLUDE:

- Unexplained cash discrepancies
- Altered or forged deposit slips
- Customer complaints about account statement balances
- Rising number of reconciling items
- Aging of reconciling items

FRAUDULENT DISBURSEMENT MAY INCLUDE:

- Check-tampering (excessive voided, missing, or destroyed checks)

FRAUDULENT WIRE OR ACCOUNT TRANSFERS

- False vendor payments
- Payroll schemes – although most banks have outsourced the payroll function
  - Forged payroll checks
  - Payroll disbursements
- Expense report fraud
- Credit card processing
- Employee home address matches that of an unrelated bank customer

HOW FRAUD OCCURS: SOME EXAMPLES

Skimming can occur at various levels within the bank, but it is most often found at the retail offices. Tellers may "borrow" cash from their drawers the night before payday—perhaps with the intent (but not the ability) to pay it back. CSRs may be extra "helpful" to elderly customers, for example, by volunteering to stand in the teller line to cash a check. Some of the cash is pocketed before it is handed over to the customer.

Both of these create "the false debit." The embezzler has two choices concerning the false debit transaction: the transaction can be allocated to an asset account or an expense account to offset the skimming transaction or the fraudulent disbursement. Either way, it can be identified and corrected with strong, up-to-date internal controls. Since there is often a specific dollar amount that repeatedly occurs on or about the same time each month (which the employee uses to pay recurring expenses), the internal audit team can conduct an ongoing sampling verification of the offsetting transactions to the cash account.

Both inside and outside the retail offices, the simplest and most popular way to steal from a bank is to simply write a check payable to the criminal and/or to forge the endorsement on the back of a check. This can often be discovered by examining checks that have existed on the outstanding list as reconciling items for a period of months. Higher-level bank employees may misappropriate using official checks, since they usually have check-signing authority on the official checks. As in the above example, this is also likely to turn up as a recurring and/or reconciling item during an internal audit.

Inappropriate wire transfers can occur if there is a lack of a procedure in place requiring the bank employee in the wire transfer department to verify the initial wire transfer information by an individual other than the person who initially requested the wire transfer. Loopholes in other procedures may allow individuals the opportunity to sweep money into accounts they control or even directly into their own accounts.

At the supervisory level, some individuals have the opportunity to practice both larceny and fraudulent disbursement. In the accounting or financial department there are usually supervisors who must approve any odd or unusual item, out-of-balance condition, or reconciling item. These individuals can misappropriate funds from unfunded official checks being carried on the books as a reconciling item, dormant accounts that are not being reviewed, altered deposit tickets, and so on, without being detected by their subordinates.

At the retail offices, the equivalent opportunity is offered the "go to" person who solves problems, often the CSR or office manager. These individuals could establish a fraudulent account and fund it with a check from an unsuspecting customer whose signature is forged.

These are only a few examples—the creativeness of dishonest employees is endless.

Internal auditors play an increasingly important role in helping banks prevent and detect employee dishonesty in the form of fraud and theft. Internal auditors should conduct periodic walk-throughs of internal control procedures over cash. This will not only help uncover fraudulent practices, but it will also highlight discrepancies between written procedures and actual practice. If employees have circumvented established internal control processes—even if innocently--they have weakened the internal control structure. A failure to practice appropriate segregation of duties, dual controls, or a secondary review process are all precursors to potential fraud.

INTERNAL AUDITORS PLAY AN INCREASINGLY IMPORTANT ROLE IN HELPING BANKS PREVENT AND DETECT EMPLOYEE DISHONESTY IN THE FORM OF FRAUD AND THEFT.

In addition, senior managers should review with employees the bank's Code of Conduct, Employee Ethics Policy, and the Whistleblower Policy. This will help remind employees of what is acceptable behavior and assure potential whistleblowers that their anonymity will be protected.

Controlling employee fraud is an ongoing challenge, especially in tough economic times. But with the proper internal controls, ongoing verifications and reviews, and a strong internal audit team, the challenge should be met.

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