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 Provided by the AICPA Fraud Task Force

Forensic and Valuation Services Section



Quick reference guide

Top misappropriation schemes



AICPA FLS Fraud Task Force Quick reference guide – Top misappropriation schemes

Overview of guide

This guide is intended to provide an easy reference to identify common indicators, resources and prevention tips for some of the most prevalent asset misappropriation schemes. It is important to differentiate on-the-books schemes from off-the-books schemes. The identification and measurement of an on-the-books scheme can be done through examination of the company's books and records, while the resources used to determine and measure an off-the-book scheme may require a different approach. The schemes profiled in this guide include both on- and off-the-books schemes.

The back of this guide provides an illustration of the fraud triangle. The factors in the fraud triangle – pressure, opportunity and rationalization – typically are present in all fraud schemes. These factors should be kept in mind while performing an investigation.

Scheme No. 10 Cash register disbursement

Description	Indicia	Validation	Prevention	Illustration of the fraud triangle
<p>False returns — This typically occurs when dishonest employees process false returns and/or voids sales that have been previously recorded. This is a form of "on-the-books" cash larceny.</p> <p>False or excess returns</p> <p>Often, a perpetrator will process a false return and take cash out of the register.</p> <p>The recordation of a return will allow the cash drawer to be "in balance" at the end of the employees' shift.</p> <p>A return might be valid, but the employee enters a value greater than the legitimate return and takes the difference.</p> <p>A tally of returns by the cashier should be kept and reviewed by management.</p> <p>Trend reports on volume of returns by cashier may be helpful in identifying employees with an unusually high amount of returns.</p> <p>Surveying that employee may allow the company to identify the scheme.</p>	<p>Unrecorded sales</p> <p>More difficult to identify than "on-the-books" since there is nothing in the register to alert the company as to the existence of this scheme.</p> <p>If the scheme is pervasive and large enough, the company may be alerted when physical inventory is taken and found to be less than expected based on company records.</p>	<p>Physical inventory records reveal significantly less inventory than expected based on recorded sales.</p> <p>Trend reports on volume of returns by cashier may be helpful in identifying employees with an unusually high amount of returns.</p> <p>Surveying that employee may allow the company to identify the scheme.</p>	<p>Ensure adequate procedures whereby a supervisor must approve all return and void transactions before monies can be given to a customer.</p> <p>Implement a policy of performing daily register reconciliations that are reviewed and monitored by management.</p>	<p>Motive/incentive/pressure</p> <p>Perceived opportunity</p> <p>Rationalization</p>
<p>Unrecorded sales — Sales persons operate remotely or are unsupervised and simply do not enter the sale in the register, instead pocketing the proceeds. This is a form of "off-the-books" cash skimming.</p>			<p>Supervision is important for all cashiers and salespersons; if they are being watched, there is less temptation to perpetrate the scheme.</p>	

Scheme No. 9

Expense reimbursement

Prevention tips

Employees submit false or overstated business expenses and receive reimbursement from their employers. The amounts are recorded on the company's books, and are likely supported with receipts and/or invoices the employee submitted.

This scheme can occur in a variety of ways:

- Submitting expenses that do not qualify for reimbursement (e.g., personal expenses)
- Manipulating receipts (or mileage) to increase the amount due
- Submitting expenses to more than one payee (e.g., employer and external organization)
- Submitting the same expense for reimbursement multiple times

Indicia

- Higher than expected mileage costs
- Higher than expected meals and entertainment costs
- Higher than expected frequency of other expenses claimed for reimbursement with a purported business purpose

Validation resource(s)

- Verify appropriateness of mileage claimed for employee trips via an internet map program.
- Compare dates expense incurred dates to employees' work schedules.
- Require detailed expense receipts if not provided.

Prevention tips

- Require detailed receipts, including documentation of business purpose.
- Require that meal and entertainment receipts include the number and names of attendees.
- Ensure that employees' supervisors review and approval all expense reports prior to payment.
- Establish policy for approval of executive management expense reports (some organizations require approval by a board member).
- Attach conference schedules to expense reports, as applicable.
- Use standard daily per diem rates for meals and incidentals.
- Establish budgets for travel and entertainment expenses by person/level, and perform budget to actual reviews of travel and entertainment expenses for each employee at least quarterly.

Elements that transcend the scheme

There are two elements that transcend the nature of a scheme. First, the lifestyle of a potential perpetrator should be considered, as an unusual and/or an extravagant lifestyle is one of the most common warning signs that an individual may be misappropriating assets. Regardless of the type of scheme employed, an individual exhibiting a lifestyle that is inconsistent with his or her apparent financial resources often is an indicator of pressure to commit one of the schemes described in this guide.

Second, consideration should be given to establishing a fraud tip line to aid in preventing and detecting a fraud. Having a fraud tip line that is available to all employees provides an effective mechanism to report suspected frauds, as employees at many organizations can communicate their concerns anonymously. A fraud tip line may also serve as a deterrent to a would-be perpetrator, as the fear of being caught may reduce the perceived "opportunity" factor in the fraud triangle and dissuade an individual from executing a scheme.

List of schemes

- Authorized check maker
- Forged checks
- Altered checks
- Billing
- Cash larceny
- Non-cash misappropriation
- Payroll
- Skimming
- Expense reimbursement
- Cash register disbursement

Description

This scheme is carried out by a person who is authorized to create and sign checks for the company. A common version of this scheme involves making the actual check payable to the perpetrator or paying for a personal expense (such as the credit card company of the perpetrator or family member), then altering the payee name in the electronic accounting records to make the disbursement appear to be made to a legitimate, authorized vendor.

Scheme No. 1 Authorized check maker

- Prevention tips
- Install video surveillance and communicate the monitoring to employees.
 - Limit the receipt of cash where practical.
 - Implement a policy of providing customers with a receipt for items purchases.
 - Ensure that there is adequate segregation of duties over the handling of cash; have the receptionist (who has no access to accounting systems) open all mail and maintain a cash receipts log.
 - Perform periodic reconciliations of the cash receipts log to the accounting system.
 - Ensure that all employees who receive checks immediately endorse the check with "For Deposit Only Account #XXXXXXX".
 - Mail monthly account statements, particularly those accounts with aged balances.

Scheme No. 8 Skimming

Description Cash receipts or negotiable financial instruments are misappropriated by an employee or member of management before being recorded in the organization's accounting records. This is considered an "off-the-books" scheme.

A common scenario involves employees who have access to cash receipts at the point of sale and recognize that the organization has inadequate internal controls to prevent the misappropriation of cash.

Another scenario involves employees who receive checks from customers on account and convert the remittances for personal gain. This scheme can often be carried out over longer periods of time before being detected if the employee also can manipulate the billing system.

Indicia	<p>Financial analysis</p> <ul style="list-style-type: none"> • Lower than expected gross revenue amount or unexpected decline in gross profit margin • Skimming often involves the misappropriation of cash receipts over a period, in relatively small amounts. • As a result, the accumulation of these misappropriations may be significant enough to draw attention to abnormalities in the indicators. 	<p>Customer complaints</p> <ul style="list-style-type: none"> • Complaints from customer about being billed for amounts previously paid (assuming the employee did not manipulate the receivables/billing system) • Complaint follow-up investigations may detect an employee is skimming the receipt of accounts receivable payments
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Validation resource(s)	<ul style="list-style-type: none"> • Install concealed video surveillance of the cash collection area. • If customer receipts are pre-numbered, inspect receipt logs for breaks in the sequence. 	<ul style="list-style-type: none"> • Send monthly account statements and/or confirmations to customers. • Examine "exception" reports in the receivables/billing system for manual adjustments to remove cash sales. • Trace cash sales from the sales journal to amounts recorded in the receivables/billing system.
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Indicia	<p>Vendor inquiry</p> <ul style="list-style-type: none"> • A vendor may call to inquire about the status of an invoice that appears within the accounting records to have already been paid. 	<p>Review of expenses</p> <ul style="list-style-type: none"> • If checks are disbursed to pay an individual's personal expenses in addition to the company's routine expenses, unusual increases in monthly expenses may be noticeable. • Note that the perpetrator may attempt to conceal the increase in expenses by preparing a manual journal entry to decrease the affected expense accounts.
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Validation resource(s)	<ul style="list-style-type: none"> • Comparisons of canceled checks with the accounting system check register to identify if there are differences between the actual and purported payees 	<ul style="list-style-type: none"> • Review of monthly expense account activity and trends and detailed analysis of anomalies can identify inappropriate payments • Review of documentation related to manual journal entries that are recorded as credits to expense accounts will identify if the journal entries are properly supported and approved
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Prevention tips	<ul style="list-style-type: none"> • Someone other than the check maker should open the bank statements and prepare the reconciliation. • Positive Pay systems may also limit the risk of this type of scheme. 	<ul style="list-style-type: none"> • For small businesses, the owner should open and review the contents of the bank statement. • If canceled checks are not included with the bank statements, an online review of the canceled checks should be performed.
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Scheme No. 2 Forged checks

Indicia
Checks not recorded in system
 • Through bank reconciliation procedures, identification of checks that have cleared the bank but are not recorded in the accounting system
 • Unusual or non-business payees or vendors, such as employees or cash

Validation resource(s)
 • Comparisons of canceled checks with the accounting system check register to determine if the checks are recorded
 • Further analysis of checks is found to be unrecorded in the system
 • Review of endorsement on check might reveal parties that are involved in the scheme.
 • Comparison of canceled checks and the accounting system check register to identify unusual/or non-business payees and checks
 • Review of the endorsement on selected check might reveal parties who are involved in the scheme
 • Review of canceled checks that appear to have different formats or fonts than the company's other canceled checks

Prevention tips
 • Develop adequate procedures to protect custody and access to the company's check stock.
 • Develop policies for adequate disposal of unused check stock.
 • Someone other than the check maker should open the bank statement, reconcile the account and report unrecorded checks to an appropriate person.
 • Someone other than the check maker should compare the canceled checks to the accounting system check register.
 • Vendor lists and check payee lists should be reviewed periodically to look for unusual or non-business payee names.

Scheme No. 7 Payroll

Description
 An employee submits false documents or manipulates the payroll system to cause the company to make improper payroll disbursements. The perpetrator may or may not have access to the company's personnel or accounting records.

A common form of payroll scheme is the overstatement of employee hours worked. In the absence of adequate internal controls, this scheme may not require a supervisor's involvement as a co-conspirator. Other types of payroll schemes include making improper increases to an employee's rate of pay, alteration of data used for bonus or commission calculations, creation of and generation of payments to "ghost" (i.e., non-existent) employees and taking possession of payroll checks related to terminated employees.

Indicia
Variances and trends
 • Actual payroll expenses by department that exceed budgeted and prior period amounts
 • Trends and anomalies in overtime hours
 • Activity reports that list changes made to employee master file data, such as position title/level and rate of pay
 • Multiple employees in the employee master file with the same employee tax ID number
 • Payments to employees outside payroll system and expense reimbursement
 • Payments made to employees for periods after termination date

Validation Resource(s)
 • Trace hours paid to approved timesheets.
 • Trace employee pay rates to human resources records.
 • Compare commission calculations to data from approved sales reports.
 • Review changes to payroll master file and compare to source documents to determine if the changes were properly approved.

Prevention tips
 • Review employee master file activity/exception reports to assess the appropriateness of employee pay-rate changes, effective dates of new employee additions and effective date of terminated employee removals.
 • Physically distribute payroll checks or payroll remittances to employees.
 • Ensure that department supervisors approve hours reported by employees in their departments.
 • Ensure that there is adequate segregation of duties regarding access to process payroll activity (approving hours reported and payroll payments to employees) and human resource activity (creating new employees and removing terminated employees).

Description	<p>An individual takes possession of materials or goods, rather than cash or financial instruments. The perpetrator typically is an employee with access to the organization's physical assets.</p> <p>The most common form of non-cash misappropriation involves the theft of inventory and often is referred to as "shrinkage." Shrinkage occurs when a physical inventory count reveals lower levels of inventory than what is reflected in perpetual inventory records. The variance represents units of physical inventory that may have been stolen.</p>	
Indicia	<p>Materials</p> <ul style="list-style-type: none"> • An individual removes inventory or other physical assets from the organization's facilities and transports them to an offsite location. • The individual either makes personal use of the assets or resells the items, typically at a discount, to another third party. 	<p>Cash in exchange</p> <ul style="list-style-type: none"> • An employee receives payment from a customer for items that the customer has purchased. • The employee takes possession of the customer's payment rather than recording the cash receipt as a sale. • The employee also removes the items from inventory and ships them to the customer.
Validation resource(s)	<p>In both schemes, the physical inventory count will yield a lower-than-expected quantity of goods on hand and is evidenced by journal entries that reduce the inventory accounting records to write off the shrinkage.</p> <p>If the organization does not use a perpetual inventory system, this scheme may go undetected for quite some time. In this instance, the company may only be alerted to a problem when management reviews the financial statements and identifies that the cost of goods sold as a percentage of sales is significantly higher than expected.</p>	
Prevention tips	<ul style="list-style-type: none"> • Establish physical and logical access controls to the warehouse(s) or supply centers to prevent employee theft. • Implement a tip line for other employees to report suspicious activity. • Review all unauthorized after-hours access to the buildings that house inventory. • Review and investigate unusual trends and anomalies related to write-offs of inventory in the accounting records. 	<ul style="list-style-type: none"> • Ensure the employees who can to receive customer payments in the office do not also have access to remove inventory items from the company's warehouse or supply center.

Description

An individual intercepts legitimate signed company checks and alters the payee and/or check amount. The person is not authorized to create or sign checks for the company, although typically, he or she is responsible for receiving banks statements with canceled checks and performing the bank reconciliations. The altered checks subsequently are destroyed to conceal the alteration.

This scheme may also be perpetrated by unrelated third parties who steal signed checks from mailboxes. The most common scenario involves altering the original payee name or amount by using chemical or mechanical means (e.g., correction fluid, "check washing" solution or pen eraser) and inserting different information, in similar print, to avoid detection.

Indicia

- Physical appearance**
- Presence of correction fluid or other physical evidence that the check has been altered
 - Canceled checks missing from the files
- Collection inquiry**
- To the extent that legitimate payees' checks are intercepted and altered, there are likely to be inquiries from the legitimate payee about the status of payment.

Validation resource(s)

- Physical examination of canceled checks, noting the presence of alterations
- Comparison of canceled checks and the accounting system check register and supporting documentation to identify discrepancies

Prevention tips

- Ensure that there is adequate segregation of duties between the individual who prepares the bank deposit slip and the individual who makes the bank deposit.
- A supervisor should ensure that the original deposit slip and bank receipt amounts match.
- The individual who makes the bank deposit should be required to return the bank receipt to the individual who prepared the original bank deposit slip (hopefully, these are two employees).
- A supervisor should ensure that the original bank deposit slip and bank receipt match.
- Use of a daily remote deposit option may reduce the opportunity for this type of scheme.

Description

An individual takes possession of cash or another negotiable financial instrument after the cash has been entered into the company's records. This is considered an "on-the-books" scheme.

A common scenario involves the theft of currency while the deposit is en route to the bank. An employee entrusted with making the bank deposit takes the cash currency portion of the deposit. To conceal the theft, the employee may supplement a check into the deposit such that the total deposit is the same, but the composition of checks and currency is not. The employee may also take checks and deposit them into another account that the employee owns/controls.

Indicia

Bank deposit currency larceny

- For a business that has an established pattern of cash receipts (in currency as opposed to checks), an unexplained change in the level of currency deposits may indicate a cash larceny scheme.

Check for cash

Substitution larceny

- Monies deposited at the bank show a composition of currency and checks different than the original deposit slip (for example, the deposit slip states \$100 in currency and \$400 in checks for a total deposit of \$500; another deposit slip is made that shows \$0 currency and \$500 in checks).

Validation resource(s)

- Comparison of the original bank deposit slip and the bank receipts will reveal differences in the total deposit.
- If one person is responsible for both preparing the bank deposit slip and making the bank deposit, then a further comparison of the sales journals cash currency receipts and the cash currency portion of the bank deposits should be performed.
- Comparison of sales journals and the original copy of bank deposit slip with the bank records
- If the currency and check portions of the company's sales records and original bank deposit slip do not match the bank records, then a check for cash substitution larceny has likely been committed.

Prevention tips

Implement adequate segregation of duties to ensure that anyone with access to check stock, or who is involved in the cash disbursement process, (1) does not receive bank statements or canceled checks and (2) is not involved in the bank reconciliation process.

- Positive Pay systems may also limit the risk of this type of scheme.
- For small businesses, the owner should open and review the contents of the bank statement.
- If canceled checks are not included with the bank statements, a review online with the bank should be performed.

Scheme No. 4 Billing	Description
<p>An employee submits fraudulent invoices to cause the organization to issue payment. The support for the check is fraudulent; however, the disbursement appears to be valid. The most common schemes include the perpetrator (1) forming a shell company to submit fictitious invoices to the victim organization, and (2) inflating or double-paying legitimate vendor invoices.</p> <p>Billing schemes are a type of "on-the-books" fraud scheme whereby false accounting entries are made to create an audit trail to cover the theft of funds.</p>	<p>Indicia</p> <p>Falsified invoices</p> <ul style="list-style-type: none"> • Identification of alterations, white-outs or handwritten notes on legitimate vendor invoices • Identification of falsified invoices submitted in the name of fictitious shell companies • Shell companies are fictitious entities used by perpetrators to open bank accounts for receiving stolen funds
<p>Validation resource(s)</p> <ul style="list-style-type: none"> • Confirmation of invoices from legitimate vendors should be considered if alterations of vendor invoices are found. • Comparison of canceled checks and the accounting system check register and supporting documentation to identify discrepancies. 	<p>Prevention tips</p> <ul style="list-style-type: none"> • Ensure that there is adequate segregation of duties between employees with responsibilities for procuring/ordering items, approving new vendors, approving vendor invoices, recording vendor invoices, paying vendor invoices and reconciling bank accounts. • Perform adequate due diligence on vendors, and maintain an up-to-date approved vendor list. • Physically observe vendors' place of business using the address indicated on their vendor invoices. • Conduct a public record search on new and existing vendors that include only a post office box on their vendor invoices.
<p>Perform periodic monitoring of vendor invoices and related information as part of pre-payment or post-payment reviews.</p> <ul style="list-style-type: none"> • Compare vendors' addresses to employee home addresses. • Carefully inspect altered vendor invoices to determine appropriateness. • Determine bank(s) of deposit vendors used (identify and investigate instances where the same vendor deposits checks at different banks – perpetrators will often open bank accounts to divert stolen funds, but use different banks to avoid suspicion). • Determine if returned checks are physically missing from monthly bank statements. • Monitor and inspect voided checks and compare to accounting system check register. 	