the Accountant

COVER STORY

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THE FADING ROLE OF BANK RECONCILIATION IN FRAUD PREVENTION AND DETECTION

Introduction

Bank reconciliation statements have traditionally served as an important control tool in detecting anomalies either in the cash book and or the bank statements. Whereas there may exist a number of anomalies in the cash book maintained by the company, there are usually few (or no) anomalies in the bank statement. In my experience with a number of corporate frauds, bank reconciliations have in most cases been least useful in tracking where fraudulent activity could have started. I have encountered companies that have had to do with "cooked" bank reconciliation statements for over two years, that is, 24 months! This period is enough to defraud the company a significant amount of money without anyone noticing.

As an accountant, you may be "perfect" in preparing a "perfectly reconciling" bank reconciliation. However, are you aware that those bank statements you have been provided with by your superior or boss could be fictitious? Are you also aware that the bank statement copy you have might be having incorrect outstanding amounts? To make it worse, are you aware that the general ledger entries have hidden reversals which may be for unallocated or unapplied receipts or payments? And to sum it up, do you know that a carefully crafted scheme may have been put designed, thanks to collusion, to cover up everything such that you, the bank reconciler, are the only one without this knowledge? These are some of pertinent issues that any accountant in any organization should be aware of and address when preparing or reviewing any bank reconciliations. However, from experience, this has not always been the case. There has been some laxity in preparing and even reviewing bank reconciliations.

Fraud antics in bank reconciliation statements

Traditionally, the bank reconciliation is used as a control tool in most organizations. The aim of the reconciliation is to primarily confirm that ledger balances correspond with bank balances. Any causes of the difference needs to be addressed during the bank reconciliation process. In this article, I discuss two antics that may be used to conceal irregularities in the bank reconciliation process.

Collusion

This is where the cashbook accountant, who prepares bank reconciliation, colludes with other staff members to beat controls around the cash book function. This may involve falsifying cash book entries through reversal of some entries. For instance, if there was a debit in the cash book, making a counter-reversal either wholly or partially to reduce the debit entry to nil. Alternatively, the scheme could be perpetrated through a reversal of a credit entry in the cash book, wither fully or partially. Some of these reversals or improper postings could be made in complex accounts such as control, posting master, unapplied receipts or suspense accounts. Collusion comes in handy when the employee making postings in the general ledger needs to get a fraudulent payment or receipt approved. Through collusion, funds that were never paid into the bank account may end up being confirmed as though they were actually received and recorded in the accounting system. Interestingly, the ledger and bank balances reconcile perfectly without these entries being highlighted!

Falsifying bank statements and providing incorrect bank balances

This whereby the person who is authorized or has access to bank statements, either from the bank itself or from the online banking platform uses software converters. Through the software, the fraudster is able to convert bank statements into editable soft copy, mainly in Excel format. In this way, the fraudster is able to manipulate entries in bank statements by deleting and/or inserting entries to cover up any fraudulent withdrawals from the bank.

Dealing with bank reconciliation fraud

Below are some tips for dealing with bank reconciliation fraud.

Preliminary reconciliations

The first tip would be to perform a "bank statement to bank statement reconciliation". This practice involves ad hoc reconciliation of bank statements provided by your superior to those obtained directly from the bank (if possible, without your superior's knowledge). How you will do this, you may need more help from higher authority especially since you may be a junior member of staff.

Next, a detailed cash book to bank statement (do not overlook the petty cash float) reconciliation may be prepared. This may seem tedious but it saves a lot since you are assured of the authenticity of all the entries in the cashbook and petty cash before performing the bank reconciliation.

Surprise bank reconciliations

This involves performing surprise bank reconciliations (on a sample basis) through special audits (just like surprise stock counts!). This could take the form of an agreed upon procedure with the client which will be guided by the requirements in ISRS 4400: Engagements to Perform Agreed-Upon Procedures Regarding Financial Information.

Cash book audits

As an alternative to surprise bank reconciliations, calling for surprise cashbook audits from independent auditors (preferably not your external auditor) because you risk calling for just another "external audit", yet this is not the objective.

Special audits

Invite special audits to check on the authenticity of bank reconciliations. I have encountered companies who have had to do with wrong bank reconciliations for the last 24 months! This amounts to wasted efforts and payment for services not rendered.

Job rotation

Job rotation can help although it may not work if there is collusion among the staff being rotated. It is advisable to rotate but do not retain for long.

Use of forensic technology tools

Technological innovations, particularly the use of information technology has created a more complex environment that requires increasing awareness and special skills to cope with fraudulent activities. Using complex software such as Caseware IDEA tool, it is now possible to:

- Perform GAP Analysis to identify and inconsistencies in transactions being processed.
- Checking for duplicate entries in payments. The IDEA tool does check for duplicate transactions in a way no other data analytic software or tool can ever do. This helps in identifying cases where fraudsters commit a payment scheme fraud by making multiple payments on a valid invoice.
- Performing Benford's test on transactional data: Benford's Law is a powerful tool in detecting fraud since is allows fraud examiners to test numbers against recognized norms. By so doing, one is able to identify patterns in transactional data and trace it to establish its authenticity. IDEA has that functionality to automatically detect fraud in transactional data on the first, second, third and fourth digits seamlessly. I recommend that corporations subject their transactional data occasionally to detect possible anomalies from time to time- say quarterly. This helps in reducing the magnitude of the fraud, if any is occurring.

Conclusion

As fraudulent schemes become more complex and more concealed, the IDEA Caseware tool is one sure way of identifying and following up on fraudulent transactions, which could be voluminous and difficult to trace one-on-one. Remember, with fraud running at endemic levels, using advanced technology helps match the complexity of fraud in today's environment. Technology helps to prevent and detect fraud and can provide positive impact on the corporation's operating performance and profitability by curtailing the effects of fraud early.