Chapter 3 – Fraud Control in Selected Industries

The suggested measures in this chapter are intended to protect the selected industries mentioned in Chapter 2.12 against fraud. The suggestions are derived mainly from prior experience in the domain areas.

3.1) Life Insurance

Some of the suggestions in addition to the current practices to minimize frauds in the life insurance sector are as follows

3.1.1) All policy holders must be subject to a random health test within twelve months of acceptance of the policy. This test must be conducted by a medical professionals who did not conduct the initial tests. The insurance company must have a panel of medical professionals and the test must be conducted by the medical professionals selected at random from the panel. The cost of the test must be borne by the insurance company. This will minimize fraudulent certifications.

3.1.2) Biometric data like finger prints, DNA tests, dental imaging, retinal scans etc. of the insured must be captured before accepting the policy and verified during the test-retest process. This will ensure that the random retest is performed on the insured and not any other person.

3.1.3) On the death of the insured, the biometric details must be captured and preserved. Biometric details like finger prints and dental details and DNA profiling can be consolidated after death. This should be a pre-condition and made mandatory before settling the death benefits.
3.1.4) There should be a strict monitoring of insurance agents. Unethical practices must be dealt with severely. This will minimize fraudulent STOLI activities.

3.1.5) In the event of an instance of suspicious death, the activities of the beneficiaries should be monitored. This is not easy and will require investigative skills.

3.1.6) The policy should have the condition that in the event of an untimely death considered suspicious by the insurance company, the death benefits will pass to the estate of the deceased that will be subjected to a separate court administration. This will lead to delays in dispensing the benefits and in the process any male-fide acts can be detected.

3.1.7) In the USA the Suitability in Annuity Transactions Act 2007 compels insurance companies and agents to provide correct and good information to potential customers. Information obtained and provided should also include (but are not limited to) the following items

- Financial Status of the customers
- The tax status of the customers
- The Investment Objectives of the customers
- Any other information that will facilitate their recommendation to the potential customer.

In India there must be strict insurance customer protection laws similar to the enactment passed in the USA.
3.2) Commercial Banks

3.2.1) Suggested Method to Discover of Hidden Bank Accounts

Some of the methods that can reveal secret accounts are

3.2.1.1) The Board Resolutions for opening bank accounts in the name of the company (if any) can be verified.

3.2.1.2) Surprise checks can reveal cheque books and pay-in slips into unauthorized bank accounts

3.2.1.3) The Tax Deducted at Source Certificate that is available as a computerized Form AS 16 can be scrutinized for unwarranted interest income that will indirectly point to the existence of secret bank accounts. Banks are obliged to deduct tax on interest payment. Interest of Certificates of Deposit or Fixed Deposits will attract the tax liability and this can be verified with the Form.

3.2.1.4) The Tax Deducted at Source Certificates from Customers or Certificates of Tax Deducted on payment to Vendors can expose the existence of secret bank accounts.

3.2.2) Suggested Method to discover Secret Accounts

The Bank Reconciliation Statement (BRS) must be accurately “tallied” at specified periods. In the statement, “stale cheques” can be identified. These must be immediately reversed as the payee cannot encash them. On reversal of the entries, the “secret reserve” is also nullified.
3.2.3) **Suggested Method to discover Inflated Expenditure**

The use of forensic accounting tools can help in identification of inflated expenses. Specifically, the use of tools like Benford’s Theorem, Relative Size Factor, Data Validation Checks, Audit Sampling tests etc. can reveal suspected inflated transactions.

3.2.4) **Suggested Methods to unearth supressed sales**

Sting operations could be conducted to ascertain the extent of fraud. In the case of a company dealing with customized gift articles, there were large differences between unit billing values. On a deeper probe on behalf of the bank, the auditor found that the company had to accept cheques from corporates and hence billed them at authorized rates. For non-corporates, the norm was payment in cash and such receipts were supressed. High Value Added Tax, Service Tax and Works Contract Tax are a major reasons why many organizations in India accept cash and supress sales.

3.2.5) **Suggested Methods to reveal diversion to associated companies**

The asset or utility purported to have been used can be verified for billings. For example the time sheets of the employees can be verified against the client billings. Tests of Reasonable Usage can be used to verify that the resources used have been compensated according to the rules of the organization.

In the case of the taxi company, an analysis of vehicle log books and driver time sheets can reveal major discrepancies.
3.2.6) **Suggested Methods to detect fake economic disasters**

The stock registers, insurance claims, surveyor reports, interviews with staff at the scene and the fire authorities can reveal facts relating to the disaster. In some cases, common arithmetic computations can help. For instance the total quantitative loss in units cannot exceed the physical capacity of the warehouse that was apparently destroyed.

Another test in the consumer durable industry is to verify whether there were unusually large orders of packing materials. At times the warehouse would be prima facie filled with packed finished goods but in reality the warehouse would contain only the packing materials with the finished materials having been usurped to an alternative place before the economic disaster.

3.2.7) **Suggested measures against Counterfeit Currency**

Staff need to be trained in noticing differences between genuine and fake currencies and currency equivalents. They also should be aware of how to use infra-red and ultra-violet scanning equipment to distinguish between fake and genuine items.
3.3) Housing Finance Loans

Though it may not be possible to totally eliminate all kinds of housing finance frauds, the frauds stated can be minimised by following certain processes as depicted in Table 3.1.

<table>
<thead>
<tr>
<th>Serial</th>
<th>Type of Fraud or Irregularity</th>
<th>Suggested Methodology for Risk Mitigation</th>
</tr>
</thead>
</table>
| 1      | Forged Documents             | • The documents should be in a dematerialized (DEMAT) format as introduced by the Karnataka Government after the Telgi stamp scam.  
• The lender should have a verification system that can cross verify with the Land Registrar details of land sale from the Land Records. |
| 2      | Multiple Financing of the same property. | • Historical records for at least thirty years along with encumbrance certificates for the period should be examined for veracity. The current original property deed should be examined and verified with the land registrar. |
| 3      | Cancellation of property after booking and availing the loan. | • There should be an agreement with the seller or builder that the prior sanction of the lender is required before the margin money is released.  
• The lender could insist on a registered mortgage if the lending value is above threshold limits. |
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| 4      | Loan disbursements encashed by third parties                     | - The name of the lender and his bank account number should be specified on the cheque.  
          |                                                                  | - The custody of the cheque until deposit should be always with the lender or the builder or seller.  |
| 5      | Overvaluation of Properties                                      | - The lending institution must develop its own valuation process staffed by competent employees.  
          |                                                                  | - The valuation should be subjected to a peer review.  
          |                                                                  | - If external valuation is resorted to, there must be at least two independent experts.  
<pre><code>      |                                                                  | - Valuation should be conducted using the Delphi technique where the identity of the experts are kept confidential.  |
</code></pre>
<p>| 6      | Sale of mortgaged property by the original person to whom the loan was granted without clearing the existing loan | - The property must be subjected to a registered mortgage if the loan exceeds a threshold value.  |</p>
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| 7      | Sale of mortgaged property by the builder without clearing the existing loan | • Statutory clearances must be obtained for the project before the loan is granted.  
• A registered mortgage is recommended if the loan value exceeds a safe limit. |
| 8      | Misrepresentation and subsequent end-use or misuse of loan granted | • Payments should be made directly to the builders after inspection of the stage of completion. |
| 9      | Fabrication of Income Tax Returns, Salary Slips etc. | • Electronic copy of Income Tax Assessments must be examined.  
• Salary credits into bank must be verified with the salary slips  
• Direct verification of employee existence must be conducted with the employer |

Table 3.1 – Suggested Processes to minimise housing loan frauds
### 3.4) Educational Institutions

Suggestions to minimize frauds in educational institutions are detailed in Table 3.2.

<table>
<thead>
<tr>
<th>Serial</th>
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| 1      | Not recording Cash Collections, Charging of Differential rates and Issue of Invalid Receipts | - There should be a system of rotation of cashiers. This will minimize the risk  
- A stratification of weekly collections arranged year-wise will indicate trends in collections. Any discrepancies can be further investigated.  
- Random checking with students can confirm the presence or absence of such an event.  
- A “Sting Operation” can be conducted using genuine students to ascertain whether amounts paid in cash are properly accounted with supporting details. |
| 2      | Sale of Scrap                | - The Internal Control System for Scrap sales must be fool proof. Assets when scrapped must follow a process.  
- Stationery must be disposed only when a “disposal limit” is reached to realize optimal price. |
<table>
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| 3      | Admission Frauds                             | • Admission frauds at the clerical stage can be resolved by publishing only the unique identification details on the official web site of the institution.  
• This information can be followed up by sending email letters followed by hard copy letters. |
<p>| 4      | Scholarship and Deposit Frauds               | • Uncollected or unutilized scholarship funds must be transferred to a separate bank account or fund after a specified period in the same manner as unclaimed dividends. Subsequent disbursements must be from only this fund through account payee cheques. |
| 5      | Unethical Sale of Question and Answer Papers | • Question papers must be photocopied only by the concerned faculty or an authorized person. In all cases the image copy in the memory of the photocopied machine must be deleted. Only a fixed number of copies must be taken and all must be accounted for. Excess copies must be physically shredded by the competent authority. |</p>
<table>
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<th>Suggested Methodology for Risk Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>Misuse of Official Facilities</td>
<td>• There should be a monitoring of facilities in the auditoriums or halls. Electricity and water meters can be installed in such places. Opening and closing readings can be taken every day. With blue tooth appliances, this can be done from remote locations also.</td>
</tr>
<tr>
<td>7</td>
<td>Unauthorized Campus Business</td>
<td>• The students are often the source of such information. Using data provided it is possible to verify whether the code of ethics has been violated or not.</td>
</tr>
<tr>
<td>8</td>
<td>Deliberate Wrong classification of Assets</td>
<td>• A stratification analysis arranged in chronological order will reveal payment patterns than are not normal. • Payments in cash made on unusual days or on holidays can be examined in detail. For instance casual labour is settled on Saturdays. If there are payments for labour on other days, this must be examined to ascertain if the transaction is genuine or otherwise</td>
</tr>
</tbody>
</table>

**Table 3.2 Suggested Processes to Minimise Frauds in Educational Institutions.**