

*What you need  
to know about*

# Check Fraud

- ✓ Why check fraud has increased substantially.
- ✓ Types of fraud you should be aware of.
- ✓ Ways to protect your company from fraud.



**FIFTH THIRD BANK™**

# CHECK FRAUD

**C**heck fraud is one of the most costly white-collar crimes, which has been increasing each year at alarming rates. Federal agencies estimate that over 1.2 million worthless checks will be negotiated each day. Nationwide check fraud losses exceed \$20 billion annually. This activity is a cost felt directly by American businesses and banks.

An increase in check fraud is occurring in an environment of declining check volume. According to the Federal Reserve, check volume in the U.S. declined at an average annual rate of 4.3% from 2000 to 2003 and, indeed, may be dropping at an even faster rate currently. For those organizations making and receiving check payments, this trend is likely to result in even greater risk to the security of their financial transactions. While the dollar amounts and number of items increase, so does the level of sophistication in check fraud – a direct result of technological advancements.

Today, technology-savvy criminals with access to a computer, a scanner, and off-the-shelf software can create hundreds of realistic looking checks in a matter of hours. And because business checks are usually written for large dollar amounts, businesses are a primary target for these fraudsters.

The problem of check fraud doesn't just affect banks; it can also impact a business's financial income, procedures, and its employees. Reports indicate that approximately 33% of all check fraud occurs from within an organization and is most likely payroll related.

Fifth Third has created this guide to offer solutions that may help protect your business against check fraud. Included is a brief description of the most common types of check fraud as well as strategies to help you reduce fraud loss.

*The best line of defense against fraud begins with you.  
Working together, we want you to enjoy a safe  
relationship with Fifth Third Bank.*

## *Why the increase in check fraud?*

### **Federal Reserve Regulation CC:**

Since 1988, when new federal regulations were introduced to accelerate check payment, check fraud has increased substantially. Under this regulation, banks must allow depositors access to their funds according to established guidelines.

This regulation was intended to speed the availability of funds. However, since the time frame a bank is permitted to hold deposited funds has been shortened, criminals now have more time to perpetrate a fraud.

### **Technology:**

High-tech crime is an ever-increasing problem for corporate America. In the past, most corporate check fraud cases involved stolen check stock. Today, with the availability of professional-quality electronic publishing and copying technology, forgers can easily reproduce corporate checks that even the CFO may not easily detect.

Inexpensive scanners allow counterfeiters to convert a check into a digital image that can then be altered using a computer. Simple desktop publishing software enables forgers to design authentic looking checks that include logos, corporate fonts, borders, and executive's signatures. All of these items can be obtained from sources such as a company's website, letterhead, and annual reports.

*Today, forgers can easily reproduce corporate checks that even the CFO may not easily detect.*

## *Types of fraud*

### **Counterfeit Checks:**

Due to advances in desktop publishing and color copying, this is the fastest growing type of check fraud. Copies of checks can easily be made on a standard black-and-white copier or on a high-quality color copier. Checks can also be reproduced via a scanner, desktop publishing software, and a printer.

### **Stolen Check Stock:**

Stolen check stock can be used by a fraudster to issue unauthorized checks from your account, which may also bear a forged signature.

### **Forged Signatures:**

Legitimate blank checks can be forged with a false maker signature, or a valid check can be endorsed and cashed by someone other than the payee (forged endorsement).

### **Altered Checks:**

This fraud occurs after a valid check has been created. The forger uses chemicals or other means to erase information. Alterations most commonly include the payee's name or the amount, but could include any other information.

### **Closed Account Fraud:**

Closed account fraud takes place when checks are written against closed accounts and presented as payment to the company. This type of fraud relies on the clearing time involved in transactions between financial institutions.

### **Fraudulent Endorsements:**

Endorsement issues may arise when a payment is due to your company, from a client. The payment could be intercepted in route, and negotiated by another party, containing a forged, improper or missing endorsement.

### **Other Unauthorized Checks:**

A common example of this would be an electronic check issued by a third-party. These checks are produced by service providers and do not include the payor/maker signature. The signature line reflects something such as "signature on file". Typically these items are not detected until the account statement is reconciled.

*To protect your business from check fraud, you should be familiar with the common check fraud schemes.*

## *Prevention of check fraud*

*Following are suggestions for tightening check security within your company:*

### **1. Use a positive pay service:**

Positive pay gives your company a streamlined way to work interactively with your bank to identify and take action against fraudulent checks, while taking advantage of the one business day window allowed to return checks. Positive pay could be considered a form of “insurance” to protect the organization from the possibility of fraud.

Positive pay involves daily reconciliation of paid check-clearing information from the bank against your company's internal check issue information in order to find discrepancies. If any discrepancies (such as check number, amount, and/or payee) exist, you can instruct the bank not to pay those checks you've determined to be fraudulent. Many organizations are able to avoid financial losses through the use of bank-provided services, such as positive pay.

- Bank maintained positive pay
  - The customer sends a file to the bank, of all checks issued
- Client maintained positive pay
  - The bank sends a file to the customer, of all in-clearing checks
- Payee name verification
  - The customer provides the payee name of the check on the issue file, for each of the checks issued
- Teller line positive pay
  - An added benefit of Bank maintained positive pay – the checks cashed by a teller are also matched to the issue file

*“Positive Pay is the best product in 25 years to deal with the problem of forged, altered, and counterfeit checks.”*

*- Frank W. Abagnale*

*Positive Pay can significantly reduce the potential losses that a company could incur from fraudulent check activity.*

## *Prevention of check fraud (continued)*

### **2. Use an ACH system:**

While check imaging and check conversion are driving paper out of the system, businesses and other organizations, unlike consumers, continue to make the bulk of their payments by check. Probably the single most effective way to avoid check fraud is to use an electronic payment system rather than checks. And because payroll check fraud is the most common type of check fraud, it makes sense to consider direct deposit of payroll. By moving payroll and other types of regular payments from a paper-based system to an electronic one, you'll do more than just protect yourself from fraud. You'll also increase the efficiency of your entire accounts payable operation.

- Fraudsters have learned that Positive Pay systems cannot detect electronic checks
- Consider using an ACH Block – can reject all ACH debits
- Consider using an ACH Filter – would allow debits from only preauthorized originators or in preauthorized amounts
- Use a separate account for all ACH and wire activity
- ACH positive pay is a new service that includes all the benefits of traditional positive pay, for ACH items

*Most security experts recommend using a variety of measures to combat check fraud.*

## *Prevention of check fraud (continued)*

### **3. Manage internal controls:**

- ❑ Use an electronic check presentment to speed the check clearing process, which may reduce losses from returned items.
- ❑ Review your bank statements promptly and diligently. As an item ages, it becomes more difficult to research, and the likelihood of recovering a loss becomes more remote. Failure to reconcile an account is an invitation for employees to embezzle.
- ❑ Separate accounts – use different accounts for collections and disbursements; electronic and check, payroll and payables.
- ❑ Segregate duties: require that at least two people be responsible for the accounts payable area. The employee issuing the checks should not be the same person who reconciles the account.
- ❑ Limit the number of signers. Notify your bank immediately of any changes in signing authorization. Make sure the authorized signers are not the same people who handle account reconciliation.
- ❑ Review hiring procedures. Keep people with dubious backgrounds out of your organization.
- ❑ Consider having employees in sensitive position bonded, as appropriate.
- ❑ Secure check stock properly. Keep blank checks and facsimile signature plates under lock and key, in separate locations. Change keys and entry codes periodically.
- ❑ Conduct surprise audits. Include a physical inventory verification of all checks.
- ❑ Ensure that mailroom procedures and personnel are sound. Mailrooms are a prime location for the theft of incoming or outgoing checks.
- ❑ Use a shredder or document destruction service to destroy cancelled checks and other financial data that is no longer needed.
- ❑ If using online banking services maintain current anti-virus and anti-spyware software on the computers.
- ❑ Do not allow employees to share login IDs and passwords. Change all default passwords.

*To effectively mitigate fraud losses banks and customers need to have a strong partnership regarding various prevention and detection methods.*

## *Prevention of check fraud (continued)*

### **4. Use secure check stock and check controls:**

Your first line of defense is to use controlled paper stock (stock not available in the retail or mail-order market) from selected printers, such as your bank. In most cases, secure paper will have a minimum of 8 security features, including micro-printing on the front and back, water marks, high resolution borders, laid lines, and so on, designed directly into the paper.

- ❑ Use a void pantograph: a screen tint background with a colored pattern in which the word “void” is hidden. If the check is copied or scanned, “void” appears on the image of the check.
- ❑ Use chemically sensitive paper. The item will become stained or the word “void” will appear in the background if certain chemicals are used to alter the check.
- ❑ Use secure number fonts, available through companies such as Standard Register, Xerox, and IBM. This software prints the dollar amount in a way that is very difficult to alter.
- ❑ Use a toner anchorage. This causes the font to be melted into the paper. Typically, toner from a laser printer can be removed very easily, making the item susceptible to alteration.
- ❑ Use thermochromatic inks and icons. This feature is heat-sensitive, causing the item to change color when raised to certain temperature. Tools needed to create checks with thermochromatic security features are not readily available to fraudsters.
- ❑ Avoid using checks that are issued in multiple different colors. Doing so prevents individuals from using the color as an indicator of possible fraud.
- ❑ Your check stock should be uniquely designed for your company.

*Using controlled paper stock for your checks, is an easy defense to check fraud.*



## *Additional Resources & Notes*

*To talk with a Fifth Third Treasury Management Specialist about ways to safeguard your company against check fraud, call your Relationship Manager.*

# CHECK FRAUD



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