

FROM SHADOWS TO SPOTLIGHT:

Understanding Internal Fraud through Case Studies,
Fraudster Profile, and Internal Audit responsibilities

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AUTHOR BIO

- With over 23 years of dedicated expertise in Banking, specializing in finance and internal audit, I currently serve as the Head of Retail & Network Branches Internal Audit Department at Raiffeisen Bank in Albania.
- I have been Lecturer at Tirana University since 2006.
- I attained certification as a Certified Fraud Examiner in 2020.
- In 2023, I achieved success in the European Audit Championship, securing the first position. Additionally, I secured the third and fifth places in the Middle East and Asia Pacific Audit Championships. Furthermore, I was ranked 22nd among 986 auditors in the Global Audit Championship organized in 2022.

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HISTORY OF BANKING SYSTEM AND BANKING FRAUD IN ALBANIA

The two-tier banking system in Albania was established in April 1992 after the fall of communism. Throughout the 1990s and early 2000s, the banking sector in Albania experienced significant growth and expansion.

In the first decade, frauds publicly disclosed far often involved customers performing fraud. However, culprits were not limited to just bank customers; employees have also been involved.

Specifically, external fraud which significantly impacts the banking system in Albania is commonly referred to as “credit fraud”.

In most cases, a bank’s internal fraud has targeted clients’ accounts. There have also been instances where employees gained unauthorized access to the bank’s assets (primarily cash held in the main vaults or ATMs).

FACTORS CONTRIBUTING TO THE LIKELIHOOD OF BANKING FRAUD IN THE CONTEXT OF ALBANIA



- Lack of a banking culture and financial literacy
- The presence of a high level of trust among bank's branch staff or between customers and staff
- Long tenure in the same position
- Lack of rotation among bank branch staff
- Migration
- Lack of whistleblowing reporting
- Nepotism
- The level of corruption

INTERNAL FRAUD CASES MADE PUBLIC

Three large internal fraud cases occurred in Albanian Banks in 2013, and one occurred in 2023.
All of them were made public in the media.

All of these cases were perpetrated by Branch Managers of three different bank branches.

2013

Two different bank branches
located in a small town

6,000 INHABITANTS

86 CUSTOMERS DEFRAUDED

FRAUD LOSS 3.6 MILLION EUR

A bank branch located in the
suburbs of the capital

SEVERAL CUSTOMERS

DEFRAUDED

FRAUD LOSS 100,000 EUR

2023

A bank branch located in the
suburbs of the capital

12 CUSTOMERS DEFRAUDED

FRAUD LOSS 300,000 EUR

The fraud cases lasted from 5 to 12 years.

The time gap of 10 years (2013-2023), digitalization, and increasing awareness of bank culture seem to have had no impact on the fraud schemes. Classical fraud schemes still prevail over newer ones.

FRAUD SCHEMES



The fraudulent activity involved:

- Fraudulent opening of Overdraft lines
- Processing of cash and non-cash transactions in customers' accounts without their knowledge.
- The perpetrators provided defrauded customers with fictitious Time Deposits agreements, Treasury Bills & Treasury Bonds certificates, to deceive them into believing their funds were invested.
- Defrauded customers placed extraordinary trust in the perpetrators, signing blank papers or payment order forms without understanding why, enabling the perpetrators to conduct transactions later without their presence
- Customers also handed over large amounts to the branch manager in his office, for which they received fictitious deposit agreements, instead of depositing them in the cash desk”

FRAUD SCHEMES

- The branch staff breached operational procedures by allowing the perpetrator to conduct transactions (both cash and non-cash) without the presence of customers.
- They also violated information security rules as the perpetrator gained access to their username/password, enabling them to manipulate the system by bypassing the 'four eyes' principle. *However, this risk is no longer imminent due to authentication factors required for personal computer access.*
- Additionally, the involved staff breached physical security procedures by permitting the perpetrator to access funds in cash alone in the main vault and the branch premises after official working hours. *This risk is also no longer imminent.*
- The perpetrators forged customers' signatures on cash slips, payment order forms, overdraft agreements, and early termination deposit requests.
- Prefilled payment order forms, either signed by customers themselves or through the forging of customers' signatures, were used to commit fraud.
- Mule accounts were employed.

REPORTS TO NATIONS 2024

- ***Perpetrator's position*** - higher levels of authority caused larger losses and lasted longer
- ***Perpetrator's tenure*** - The longer the perpetrators had been employed at the victim organization, the higher the median losses they caused.
- ***Perpetrator's gender*** - Male perpetrators outnumbered female perpetrators almost three to one
- ***Perpetrator's age*** - Perpetrators between the ages of 31 and 50 carried out 69% of the frauds
- ***Collusion by multiple perpetrators*** - More than half (54%) of the frauds were carried out by multiple perpetrators colluding, rather than a single fraudster acting alone
- ***Perpetrators' criminal background*** - Many perpetrators (87%) had never been either charged with or convicted of a fraud-related offense,

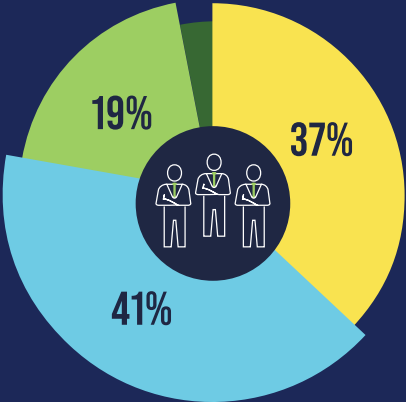
PROFILE OF A FRAUDSTER

LEVEL OF AUTHORITY

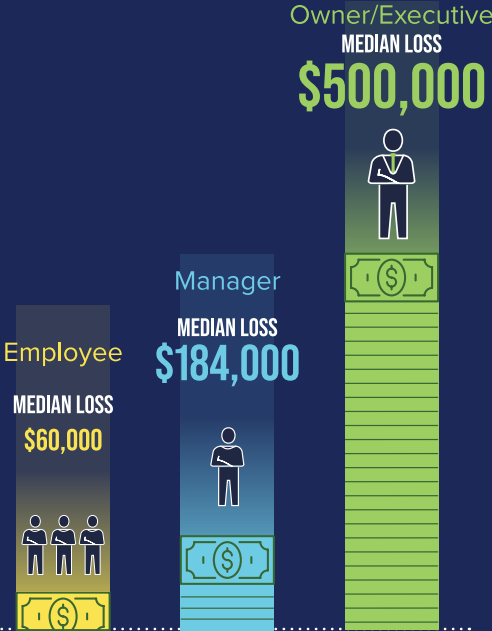


Most fraudsters were employees or managers, but **FRAUDS PERPETRATED BY OWNERS AND EXECUTIVES WERE THE COSTLIEST.**

PERCENT OF CASES



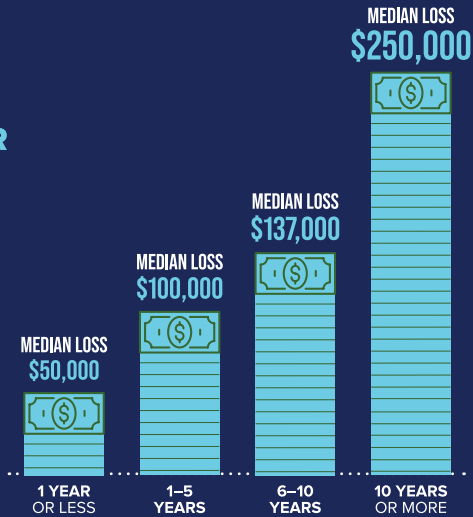
Employee Manager Owner/Executive



Source: ACFE _ Occupational Fraud 2024 _ A Report to the Nations

TENURE

THE LONGER a fraudster has worked for an organization, **THE MORE COSTLY** their fraud.



GENDER

WOMEN committed fewer frauds and caused lower losses.



\$158,000
MEDIAN LOSS



\$100,000
MEDIAN LOSS

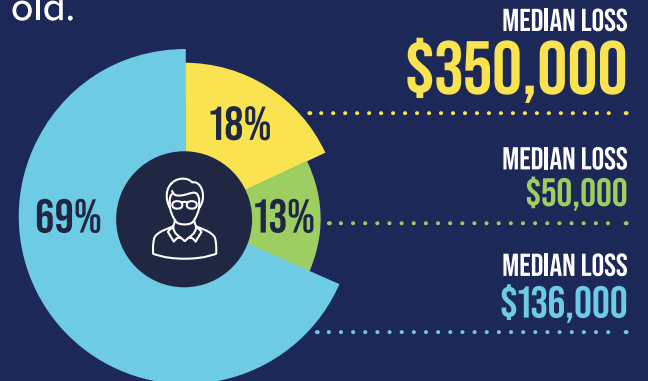


AGE MORE THAN TWO-THIRDS of fraudsters were 31–50 years old.



FRAUDSTERS OVER THE AGE OF 50 caused the highest median losses.

- <31
- 31–50
- >50



Source: ACFE _ Occupational Fraud 2024 _ A Report to the Nations

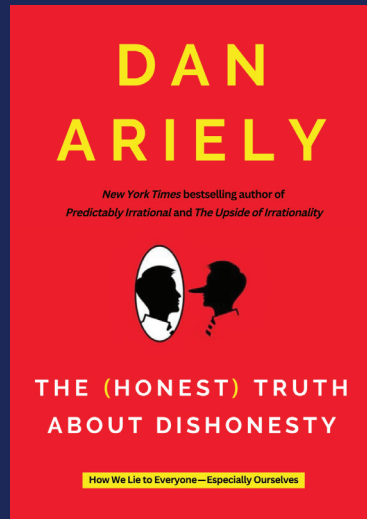
FRAUDSTER PROFILES:

A Comparison with the Identikit from the Report to Nations

- In all four fraud cases, the perpetrator profiles align with the statistics and identikit issued by ACFE.
- Three of them were male, and one was female.
- All of them had held the same position (Manager of the same branch)
- For many years, which facilitated the perpetration of fraud due to their long tenure.
- Each began committing fraud in their 30s.
- All 'colluded' with employees, although this collusion was not always intentional. Several employees, particularly the youngest and least experienced, were unknowingly involved in the fraud, becoming victims of their supervisors.
- Especially the youngest ones simply don't recognize what fraud looks like.

THE HONEST TRUTH ABOUT DISHONESTY

The well-known author Dan Ariely, in his book “THE HONEST TRUTH ABOUT DISHONESTY”, asserts that:



1% of the population will consistently remain honest, never stealing.

Another 1% will consistently be dishonest, attempting to steal whenever the opportunity arises.

The majority will typically adhere to honesty under certain conditions, but if tempted enough, they may succumb to dishonesty.



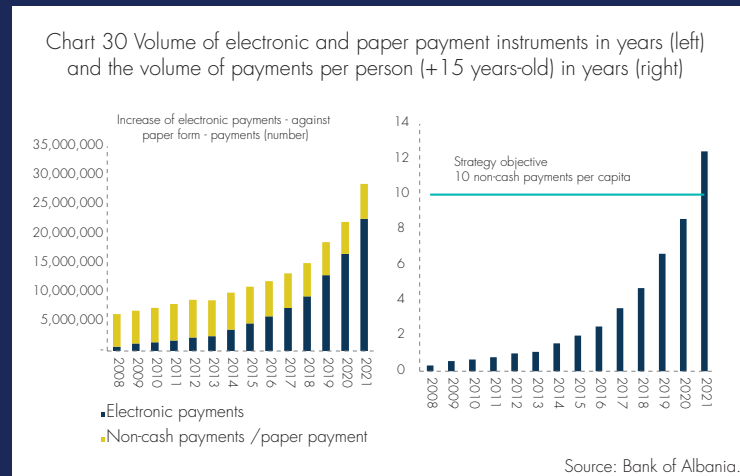
FRAUD MOTIVATION



- The motivation for a long-term employee to engage in fraud is complex and can be influenced by various factors.
- The true motivation behind the fraud is never confirmed, although it is reported to be linked to financial needs arising from health issues within their families.
- Conversely, other theoretically known factors such as lack of career advancement, unfair treatment, or fear of job loss seem to be irrelevant in the aforementioned cases.

PERSISTENT INSTANCES OF CLASSICAL FRAUD IN AN INCREASINGLY DIGITAL WORLD

In this increasingly digital world, including Albania, banks are still vulnerable to classical fraud.



Fraudsters will continue to exploit system vulnerabilities, considering that:

- **21%** of payments are in paper forms. The National Strategy on the Modernization of Retail Payment (2018–2023) aimed for significant improvements. A report from the Bank of Albania in 2012 indicated that **96%** of transfers were initiated in paper form at banks' windows, but by 2021, about **20.65%** of total payment volume comprised credit transfers in paper form, with card payments accounting for **55.57%**.

Shqipëria s'e harron zakonet e vjetër të pagesave "cash", më të lartat në Evropë



- Cash usage remains prevalent in Albania due to factors such as informal economic activities, cultural preferences, and limited banking access in certain areas, highlighting the importance of alternative payment channels.



- A government's initiative to channel retirement pensions into banks may heighten the risk of fraud.

FINANCIAL LITERACY

By equipping individuals with better knowledge of financial products and services, as well as the associated risks, they become less susceptible to fraud and abuse.

However, based on data from a 2019 survey on financial literacy conducted by the Bank of Albania using OECD/INFE methodology, the results are not optimistic:

- Individuals in Albania possess only 53% of the total knowledge, behavior, and financial attitudes.
- Only 54% of individuals in Albania are familiar with at least five financial products, compared to 83% globally.
- Merely 27% of individuals in Albania exhibit minimum appropriate financial behavior, a

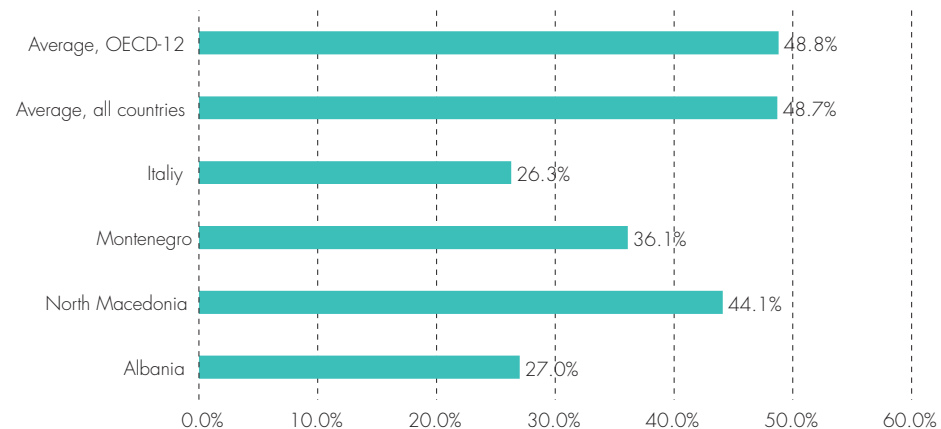
percentage lower than the global and regional averages.

- Both the recognition and use of financial products in Albania fall below the average of the participating survey countries and OECD countries.
- Only 54% of individuals in Albania are familiar with financial products, which is lower than the global average (83%) and OECD countries (86%), and even lower than regional levels.

Table 1 Financial literacy index and its components for Albania and other countries

	Financial knowledge	Financial behavior	Financial attitude	Financial literacy index
Albania	3.7	4.3	3.2	11.2
North Macedonia	3.9	5.1	2.8	11.7
Montenegro	4.1	4.7	2.6	11.5
Italy	3.9	4.2	3.0	11.1
Average, all countries	4.4	5.3	3.0	12.7
Average, OECD-11	4.6	5.3	3.1	13.0

Chart 2 Percentage of individuals with minimum financial behavior (financial behavior index value 6 or more)



Source: OECD, (2020), data obtained from the Survey on financial literacy in Albania (2019)

Lessons Learned *on the*
AUDIT TRAIL



There are times when internal audit clients and others have unrealistic expectations about our profession. It's not surprising, then, that there may be confusion about our role. After all, internal auditors wear many hats. We are analysts, controls experts, consultants, teachers, business partners, watchdogs, financial advisers, compliance experts, and more. While we might be able to audit anything, we can't audit everything.

At best, the internal audit function can only be as effective as the resources, training, and talent that are available. Internal auditors are not infallible, and given the realities of budgets and cost justifications, we also cannot be omnipresent.

Richard Chambers



EXAMINING INTERNAL AUDIT RESPONSIBILITIES IN FRAUD DETECTION: ADDRESSING BLAME AND ACCOUNTABILITY



Every time a fraud occurs, the question that emerges in these cases is:

‘Why was this not detected by internal audit?’

Internal audit is immediately blamed for not discovering the fraud during audit procedures, and the finger is pointed at audit, much in the same way as at the perpetrator.

Even when an investigation is carried out, and ironically, the audit is conducting the investigation alone or in collaboration with an investigation team, you still hear voices stating that the responsibility lies with audit, without considering the conclusions of the investigation, the fraud scheme, the level of collusion, etc.”

EXAMINING INTERNAL AUDIT RESPONSIBILITIES IN FRAUD DETECTION: ADDRESSING BLAME AND ACCOUNTABILITY

ACFE's Report to the Nations points out the fact that auditors rarely find fraud—internal audit detects fraud **14%** of the time, while external audit merely **3%** of the time.

Source: ACFE _ Occupational Fraud 2024 _ A Report to the Nations

FIG. 13 HOW IS OCCUPATIONAL FRAUD INITIALLY DETECTED?

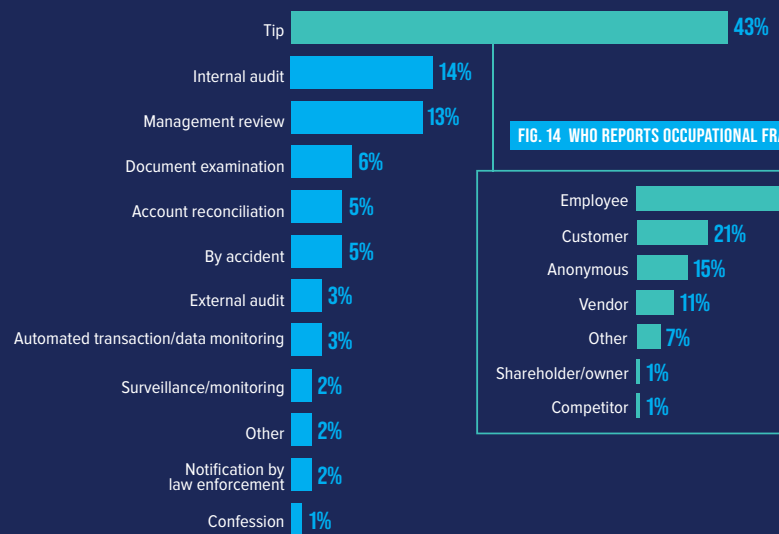
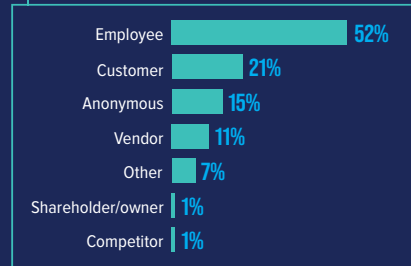


FIG. 14 WHO REPORTS OCCUPATIONAL FRAUD?



EXAMINING INTERNAL AUDIT RESPONSIBILITIES IN FRAUD DETECTION: ADDRESSING BLAME AND ACCOUNTABILITY



There is an expectation gap and misunderstandings regarding what internal auditors are expected to review, audit and detect.

Compliance with international auditing standards is paramount for Internal Audit to fulfill their responsibilities effectively, especially in banks where various regulations outline their duties.

One reason auditors rarely find fraud is that audits are not typically designed to detect or prevent fraud. The International Professional Practices Framework (IPPF), the conceptual framework that organizes authoritative guidance for Internal Auditors (IIA), resolves all the misunderstanding.

EXAMINING INTERNAL AUDIT RESPONSIBILITIES IN FRAUD DETECTION: ADDRESSING BLAME AND ACCOUNTABILITY

IPPF Standard 1210.A2 - Internal auditors' knowledge / proficiency

- Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the way it is managed by the organization but **are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.**

IPPF Standard 1220.A1 - Due professional care

- Internal auditors must exercise due professional care by considering the:
 - Probability of significant errors, fraud, or noncompliance.

IPPF Standard 2120 - risk management

- *2120.A1* - the internal audit activity must evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the:
 - Reliability and integrity of financial and operational information.
 - Effectiveness and efficiency of operations and programs;
 - Compliance with laws, regulations, policies, procedures, and contracts; and Safeguarding of assets.
- *2120.A2* - the internal audit activity must evaluate the potential for the occurrence of fraud and how the organization manages fraud risk.

EXAMINING INTERNAL AUDIT RESPONSIBILITIES IN FRAUD DETECTION: ADDRESSING BLAME AND ACCOUNTABILITY

Summarizing what standards require from audits, the primary responsibility does not solely lie with the audit.

While not the primary focus, internal audit procedures may, in the course of our work, uncover indicators of potential fraud.

However, there are several issues that can impact the quality of internal auditors in not detecting fraud.

EXAMINING INTERNAL AUDIT RESPONSIBILITIES IN FRAUD DETECTION: ADDRESSING BLAME AND ACCOUNTABILITY



Rotation and conflict of interest. When there is a lack of rotation in internal audit and combined with other key roles in bank, it can have several potential impacts on the ability to identify and prevent internal fraud.

- Loss of objectivity and potential for collusion
- Reduced skepticism and decreased effectiveness
- Stagnation of skills and knowledge



The audit warnings were not addressed satisfactorily
by management and high - level managers.

Ineffective communication auditors - auditees,
frequently becomes an obstacle and has its impact
in facilitating the occurrence of fraud and remaining
undetected.

Internal audit resources are not enough to cover all the significant risks. Moreover, there is a lack of offers for internal auditors.





The audit universe is too broad in terms of the number of audit fields to be covered compared to the number of auditors available.

Sampling is never enough, therefore creating a high probability that a fraudulent transaction will not be captured in the auditors' sample and, therefore, will go undetected.

Time constraints. Auditors are also required to meet deadlines and audit the component of audit universe within the designated time frame as stipulated by authorities

WHERE IS INTERNAL AUDIT GOING?

Will the new standards reduce the expectation gap on fraud detection by auditors?

How will the significant gap between experienced auditors and new auditors be smoothed?

How will AI assist Internal Audit in better detecting fraud?





“

*What's the worst that can happen?
You get outsourced?*

Don't change, and that will happen anyway

Mike Jacka

”

