Payments Fraud and Control Survey

Report of Survey Results

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JPMorganChase

Association for Financial Professionals
7315 Wisconsin Avenue, Suite 600 West, Bethesda, MD 20814
301.907.2862 Fax 301.907.2864 www.AFPonline.org

Payments Fraud and Control Survey

Introduction

Payments fraud is on the rise and treasury and finance professionals are raising their defenses against it. They are taking action to protect their organizations against criminals and reduce their exposure to fraud losses.

AFP conducted a survey in February 2005 to throw light on the nature and frequency of fraudulent payment attacks that its members' organizations experienced during 2004, and the internal measures and bank services that they use to control check and ACH fraud. The Association seeks to promote greater awareness of actions that payment system participants can take to guard against the fraud that can undermine their organization's security and financial controls as well as the safety and soundness of the U.S. payments system.

AFP would like to thank JPMorgan Chase for their sponsorship of the Payments Fraud and Control Survey.

Highlights of Survey Results

Key findings of the Payments Fraud and Control Survey include:

- Fifty-five percent of survey respondents indicate that their organization was a victim of payments fraud in 2004.
  - Nearly three-quarters of organizations with annual revenues greater than $1 billion experienced fraud compared to 37 percent of smaller organizations.
  - For organizations that were victims of payments fraud in 2004, the median dollar amount of the fraud was $26,600.
- Checks are the most likely vehicle for payments fraud.
  - Among organizations that were subject to payments fraud in 2004, 94 percent indicate that they were victims of check fraud.
  - Thirty-four percent indicate that they were the victims of ACH debit fraud.
- Organizations use a variety of internal and bank-provided services to guard against payments fraud.
  - Virtually all organizations separate disbursement and reconciliation duties and use security features on their check stock.
  - Eighty-eight percent of organizations use positive pay or reverse positive pay.
  - Seventy-one percent of organizations use ACH debit blocks.
  - ACH debit filters are used by slightly over half of respondents.
- Seventy-nine percent of organizations indicate that they stopped at least one incident of payments fraud in 2004.
  - Ninety-one percent of larger organizations report that they stopped at least one incident of payments fraud compared to 67 percent of smaller organizations.
- Respondents consider the use of electronic payments—specifically ACH payments—to have a significant impact on their organization's exposure to fraud.
  - Increasing use of ACH credits to make payments is expected to reduce fraud exposure.
  - Increasing permission for ACH debits to its accounts to make payments is expected to increase an organization's exposure to fraud.

Survey Findings

Incidence of Fraud

Payments fraud is pervasive. The majority of organizations suffered at least one incident of payments fraud in 2004. Criminals were much more likely to have attacked larger organizations. Organizations with revenues greater than $1 billion were about twice as likely to have experienced fraud as smaller organizations.

Fifty-five percent of survey respondents indicate that their organization was a victim of payments fraud in 2004. Nearly three-quarters of large organizations experienced fraud, while 37 percent of smaller organizations—those with revenues under $1 billion—indicated that they were victims of fraud.

Was Organization a Victim of Payments Fraud in 2004?

(Percentage Distribution)

	Total	Under $1 billion	Over $1 billion
Organization was victim of payments fraud in 2004	55%	37%	73%
Organization was not victim of payments fraud in 2004	45	63	27

Checks are the most likely vehicle for payments fraud. Among organizations that were subject to payments fraud in 2004, 94 percent indicate that they were victims of check fraud. This is true for both large and small organizations. Since the majority of organizations make more than 80 percent of their payments by check, according to a 2004 AFP Electronic Payments Survey, it is not unexpected that the most frequently used payment method should be the most frequent target of attack.

ACH debit is the payment method having the second highest percentage of organizations reporting fraud. Thirty-four percent of respondents indicate that their organizations were the victims of ACH debit fraud in 2004. As in the case of checks, organizations with revenues greater than $1 billion are much more likely to be victims of ACH debit fraud than smaller organizations. Forty-five percent of large organizations report having had fraudulent debits against their accounts in 2004, versus 28 percent of smaller organizations. Since ACH debits are infrequently used in business-to-business payment transactions, according to the AFP electronic payments survey, their use for fraudulent transactions is noteworthy.

The AFP survey also indicated that ACH credits are the most widely used business-to-business electronic payment method. ACH credits experienced the lowest percentage of reported fraud in 2004.

Payment Methods Subject to Fraud in 2004

(Percentage of Organizations Subject to Payments Fraud in 2004)

	Total	Under $1 billion	Over $1 billion
Checks	94%	88%	97%
ACH debits	34	28	45
Consumer credit cards	14	14	13
Corporate purchasing cards	11	12	11
Consumer debit cards	4	6	2
ACH credits	3	2	3

Four out of five organizations that were subject to payments fraud in 2004 indicate that the largest dollar amount of fraud resulted from check fraud. The second highest percentage of organizations—eight percent—indicates that their largest dollar amount of fraud was caused by consumer credit cards. The high level of consumer credit card fraud was twice as likely to be reported by organizations with revenues under $1 billion as by larger organizations. Five percent of organizations report that the largest dollar amount of fraud was caused by ACH debits.

Payment Method with the Largest Dollar Amount of Fraud in 2004

(Percentage Distribution of Organizations Subject to Payments Fraud in 2004)

	Total	Under $1 billion	Over $1 billion
Checks	81%	78%	83%
Consumer credit cards	8	12	6
ACH debits	5	6	5
Corporate purchasing cards	4	4	5
ACH credits	1	*	1
Consumer debit cards	1	*	1

For organizations that were victims of payments fraud in 2004, the median dollar amount of all payments fraud was $26,600. Large organizations experienced twice the dollar amount of payments fraud as smaller organizations. At organizations with revenues over $1 billion, the median dollar amount of payments fraud was $37,600, compared with a median value of $18,100 at smaller organizations.

Large organizations were more often hit by very high dollar payment fraud attacks. Thirteen percent of organizations with revenues greater than $1 billion report that they were subject to at least $250,000 in payments fraud in 2004. Another 34 percent of large organizations estimate their total dollar amount of payments fraud to be between $50,000 and $249,000.

On the other hand, less than one percent of smaller organizations estimate their total dollar amount of payments fraud in 2004 to be at least $250,000, and only 12 percent report payments fraud of between $50,000 and $249,000.

Seven percent of organizations that reported they were victims of payments fraud in 2004 indicate a zero dollar amount of payments fraud, most likely because they were able to stop the fraud and sustained no losses.

Estimated Value of Payments Fraud in 2004

(Percentage Distribution of Organizations Subject to Payments Fraud in 2004)

	Total	Under $1 billion	Over $1 billion
No dollar damages	7%	4%	8%
Under $25,000	41	63	31
$25,000-49,999	16	20	13
$50,000-99,999	13	8	15
$100,000-249,999	14	4	19
$250,000-499,999	5	*	7
$500,000 and above	4	*	6
Median value	$26,600	$18,100	$37,600

Survey respondents report that the largest percentage of fraud at their organizations in 2004 was carried out by third parties. At more than 75 percent of organizations, all payments fraud was carried out by external parties. Only seven percent of organizations indicate that all payments fraud was carried out internally, for example, by full, part-time or temporary employees.

Financial institutions bear the greatest liability for financial losses resulting from fraud. Survey respondents report that banks were financially responsible for two-thirds of organizations' fraud losses in 2004. Forty-four percent of organizations indicate that the third party's bank—the depository bank—bore the greatest liability for losses, while another 23 percent report that their bank bore that liability. Only seventeen percent of organizations that were victims of payments fraud indicate that they bore the greatest financial liability.

Party Responsible for the Greatest Liability for Losses Resulting from Fraud in 2004

(Percentage Distribution of Organizations Subject to Payments Fraud in 2004)

	Total	Under $1 billion	Over $1 billion
The organization	17%	22%	15%
The organization's bank	23	20	24
The organization's insurance company	1	*	1
The third party's bank	44	40	46
Other	15	18	14

Guarding Against Fraud

Internal defenses

There are a number of defenses that organizations can implement internally to protect themselves against check, ACH and wire fraud. All of those listed in the survey are used to some extent by respondents' organizations, but some are much more widely adopted than others. Moreover, they are more likely to be in place at large organizations with revenues over $1 billion than at smaller organizations.

Virtually all companies separate disbursement and reconciliation duties and use security features on their check stock.

About two-thirds of organizations have implemented a second set of three defensive measures: they have dual security administrators for their electronic payments system, control access to payment processing areas, and reconcile electronic payment accounts on a daily basis.

Less than half of organizations have put other important defenses in place, and they are significantly more likely to be larger organizations. These fraud controls include reconciling checking accounts on a daily basis, establishing separate accounts for checks and electronic payments, and placing a "post no checks" restriction on electronic payment accounts.

Internal Measures in Place to Guard Against Check, ACH and Wire Fraud

(Percentage of Respondents)

	Total	Under $1 billion	Over $1 billion
Separation of disbursement and reconciliation duties	94%	95%	94%
Security features on check stock	91	91	92
Dual security administrators for electronic payments systems	69	61	76
Controlled access to payment processing areas	68	65	70
Daily reconciliation of electronic payment accounts	63	60	66
Daily reconciliation of checking accounts	47	44	50
Separate accounts for check and electronic payments	46	39	51
Replacement of employee pay checks with electronic pay (direct deposit or payroll cards)	45	44	46
“Post No Checks” restriction on electronic payment accounts	22	10	33
Separate accounts for ACH debits and ACH credits	11	9	14
Other	17	13	10

Bank fraud control services

Banks offer several check and ACH fraud control services to their business customers. Some services are widely available, others have been introduced more recently or by selected banks.

Use of positive pay or reverse positive pay to guard against check fraud is considered a best practice, and eighty-eight percent of respondents’ organizations use this service. However, there is a significant difference in usage by size of organization— 98 percent of larger organizations use positive pay vs. 76 percent of smaller ones.

Payee positive pay, somewhat less frequently available, is used by about one-third of organizations.

To control ACH fraud, 71 percent of organizations use ACH debit blocks. As with positive pay for checks, there is a significant difference in usage by size of organization—81 percent of larger organizations use ACH debit blocks vs. 53 percent of smaller ones.

ACH debit filters, another service to prevent unauthorized ACH debits, are used by slightly over half of respondents.

Organizations identified several reasons for not using bank-provided check and ACH fraud control services. Among the most widely cited are: the potential fraud loss is not worth the cost, the service is technically difficult to implement, or the bank does not offer the service. About one quarter of respondents who do not use ACH fraud control services have not discussed them with their bank, perhaps because they do not consider themselves at risk of ACH fraud.

Banks that Offer Check and ACH Fraud Control Services and Organizations' Use of Them

(Percentage Distribution)

	Bank offers service and organization uses it	Bank offers service but organization does not use it	Bank does not offer service	Don't know
Check Fraud Service:				
Positive pay and reverse positive pay	88%	9%	1%	1%
Payee positive pay	30	35	19	16
ACH Fraud Service:				
ACH debit blocks	71%	19%	1%	9%
ACH debit filters	53	26	3	18
Combined check and ACH reconciliation	35	14	9	42
ACH positive pay	19	26	11	44

Because of either internal defenses or bank fraud control services, 79 percent of organizations indicate that they stopped at least one incident of payments fraud in 2004. Larger organizations report greater success—91 percent with annual revenues greater than $1 billion stopped at least one incident of payments fraud compared to 67 percent of smaller organizations. As noted earlier, larger organizations are more likely to have been victims of fraud and to have implemented both internal and bank-provided fraud controls.

Organization's Fraud Controls That Stopped at Least One Incident of Payments Fraud in 2004
(Percentage Distribution)

	Total	Under $1 billion	Over $1 billion
Fraud controls stopped at least one incident of payments fraud in 2004	79%	67%	91%
Fraud controls did not stop at least one incident of payments fraud in 2004	21	33	9

Fraud control options

Most organizations would not change disbursements banks to obtain check and/or ACH fraud control services that their current bank does not offer. Sixty percent of respondents indicate that their organization would not change its bank for that reason. However, a segment of customers would be likely or very likely to switch banks to obtain needed fraud control services. That group includes 45 percent of large organizations and 34 percent of smaller organizations.

Likelihood of Changing Disbursement Banks to Obtain Check and/or ACH Fraud Control Services that Current Bank Does Not Offer
(Percentage Distribution of Organizations that Reported that their Banks Do Not Offer Certain Fraud Control Services)

	Total	Under $1 billion	Over $1 billion
Very likely	13%	11%	15%
Likely	27	23	30
Not very likely	45	49	41
Not at all likely	15	18	13

Respondents consider the use of electronic payments—specifically ACH payments—to have a significant impact on their organization's exposure to fraud. Increasing use of ACH credits to make payments is expected to reduce fraud exposure. Increasing permission for ACH debits to its accounts to make payments is expected to increase an organization's exposure to fraud.

Fifty-four percent of respondents believe their organization would reduce its exposure to fraud if it increased its use of ACH credits. Slightly more than one-third believes use of ACH credits would have no impact on fraud.

On the other hand, sixty-nine percent of respondents believe their organization would have greater exposure to payments fraud if they were to allow more ACH debits to their accounts. About 21 percent believes increasing use of ACH debits would have no impact on exposure to fraud.

Expected Impact on Organization's Exposure to Fraud Should Organization Increase Use of ACH Credits to Make Payments

(Percentage Distribution)

	Total	Under $1 billion	Over $1 billion
Reduced exposure	54%	50%	59%
Increased exposure	7	12	3
Remain about the same	38	38	38

Expected Impact on Organization's Exposure to Fraud Should Organization Increase Use of ACH Debits to Make Payments

(Percentage Distribution)

	Total	Under $1 billion	Over $1 billion
Reduced exposure	10%	11%	9%
Increased exposure	69	64	73
Remain about the same	21	25	18

Conclusions

Payments fraud is a nationwide problem, reflected in the fact that the majority of organizations suffered at least one incident of payments fraud in 2004. Organizations with revenues greater than $1 billion were about twice as likely to have experienced fraud as smaller organizations, and that fraud is also more likely to be for higher dollar amounts. The largest percentage of fraud is reported to have been carried out by third parties, rather than internally by employees.

Checks—the most widely used payment method—is the most frequent subject of fraud. ACH credits—the most frequently used electronic payment method for business-to-business transactions—experienced the lowest percentage of reported fraud in 2004. On the other hand, ACH debit is the payment method having the second highest percentage of organizations reporting fraud.

Financial institutions bear the greatest liability for financial losses resulting from fraud. Survey respondents report that banks were responsible for two-thirds of organizations' fraud losses in 2004. Only 17 percent of organizations that were victims of payments fraud indicate that they bore the greatest financial liability.

Virtually all companies have adopted basic internal fraud controls—separation of disbursement and reconciliation duties and security features on check stock. However, less than half of organizations have put other important defenses in place, and they are significantly more likely to be larger organizations. These fraud controls include reconciling checking accounts on a daily basis, establishing separate accounts for checks and electronic payments, and placing a "post no checks" restriction on electronic payment accounts.

The most widely used bank-provided fraud control services are positive pay for checks and ACH debit blocks. Among the most widely cited reasons for not using a fraud control service: the potential fraud loss is not worth the cost, the service is technically difficult to implement, or the bank does not offer the service. While most organizations would not change disbursement banks to obtain fraud control services that their current bank does not offer, a segment of customers—one-third or more—would be likely to do so.

Because of the high incidence of payments fraud, organizations are vulnerable to attack and should consider implementing additional internal efficiencies and controls that may provide long-term benefits for the security of their payment systems. To deal with electronic payments fraud, financial institutions should consider providing and promoting a wider selection of ACH debit fraud control services, as well as the check fraud services they currently offer.

Internal controls and bank services should work together. As one respondent commented, "Although we have experienced many instances of attempted fraud—check, ACH, consumer credit card—we have not suffered any losses. I credit this to positive pay, separation of bank accounts that issue checks vs. wire/ACH, and constant vigilance by our controlled disbursing bank." Another respondent concluded, "Positive pay, payee positive pay, debit blocks and debit filters are essential tools in today's environment."

About the Survey

In February 2005, the Association for Financial Professionals sent a 15-question survey to 2,500 financial professionals about payments fraud issues impacting their organization. The survey was sent to AFP corporate practitioner members with these job titles: cash managers, assistant treasurers, directors and controllers. After eliminating surveys sent to invalid and/or blocked email addresses, the 256 responses yield an adjusted response rate of 14 percent. AFP also sent the survey to prospective members and generated an additional 34 responses.

AFP would like to thank JPMorgan Chase for their sponsorship of the Payments Fraud and Control Survey. The Association for Financial Professionals retained total editorial control over both the survey questionnaire and final survey report.

Profile of Survey Respondents

Financial professionals who responded to the survey on behalf of their organizations are representative of AFP's membership as a whole. The typical respondent works for an organization with annual revenues slightly higher than $1 billion. The largest percentage of respondents is employed in manufacturing.

Association for
Financial Professionals®

About the Association for Financial Professionals

The Association for Financial Professionals (AFP) headquartered in Bethesda, Maryland, supports more than 14,000 individual members from a wide range of industries throughout all stages of their careers in various aspects of treasury and financial management. AFP is the preferred resource for financial professionals for continuing education, financial tools and publications, career development, certifications, research, representation to legislators and regulators, and the development of industry standards.

General Inquiries	AFP@AFPonline.org
Web Site	www.AFPonline.org
Phone	301.907.2862