The Greater Providence Deposit & Trust Embezzlement

Nino Moscardi, president of Greater Providence Deposit & Trust (GPD&T), received an anonymous note in his mail stating that a bank employee was making bogus loans. Moscardi asked the bank's internal auditors to investigate the transactions detailed in the note. The investigation led to James Guisti, manager of a North Providence branch office and a trusted 14-year employee who had once worked as one of the bank's internal auditors. Guisti was charged with embezzling $1.83 million from the bank using 67 phony loans taken out over a three-year period.

Court documents revealed that the bogus loans were 90-day notes requiring no collateral and ranging in amount from $10,000 to $63,500. Guisti originated the loans; when each one matured, he would take out a new loan, or rewrite the old one, to pay the principal and interest due. Some loans had been rewritten five or six times.

The 67 loans were taken out by Guisti in five names, including his wife's maiden name, his father's name, and the names of two friends. These people denied receiving stolen funds or knowing anything about the embezzlement. The fifth name was James Vanesse, who police said did not exist. The Social Security number on Vanesse's loan application was issued to a female, and the phone number belonged to a North Providence auto dealer.

Lucy Fraioli, a customer service representative who cosigned the checks, said Guisti was her supervisor and she thought nothing was wrong with the checks, though she did not know any of the people. Marcia Perfetto, head teller, told police she cashed checks for Guisti made out to four of the five persons. Asked whether she gave the money to Guisti when he gave her checks to cash, she answered, "Not all of the time," though she could not recall ever having given the money directly to any of the four, whom she did not know.

Guisti was authorized to make consumer loans up to a certain dollar limit without loan committee approvals, which is a standard industry practice. Guisti's original lending limit was $10,000, the amount of his first fraudulent loan. The dollar limit was later increased to $15,000 and then increased again to $25,000. Some of the loans, including the one for $63,500, far exceeded his lending limit. In addition, all loan applications should have been accompanied by the applicant's credit history report, purchased from an independent credit rating firm. The loan taken out in the fictitious name would not have had a credit report and should have been flagged by a loan review clerk at the bank's headquarters.

News reports raised questions about why the fraud was not detected earlier. State regulators and the bank's internal auditors failed to detect the fraud. Several reasons were given for the failure to find the fraud earlier. First, in checking for bad loans, bank auditors do not examine all loans and generally focus on loans much larger than the ones in question. Second, Greater Providence had recently dropped its computer services arrangement with a local bank in favor of an out-of-state bank. This changeover may have reduced the effectiveness of the bank's control procedures. Third, the bank's loan review clerks were rotated frequently, making follow-up on questionable loans more difficult.

Guisti was a frequent gambler and used the embezzled money to pay gambling debts. The bank's losses totaled $624,000, which was less than the $1.83 million in bogus loans, because Guisti used a portion of the borrowed money to repay loans as they came due. The bank's bonding company covered the loss.

The bank experienced other adverse publicity prior to the fraud's discovery. First, the bank was fined $50,000 after pleading guilty to failure to report cash transactions exceeding $10,000, which is a felony. Second, bank owners took the bank private after a lengthy public battle with the State Attorney General, who alleged that the bank inflated its assets and overestimated its capital surplus to make its balance sheet look stronger. The bank denied this charge.

1. How did Guisti commit the fraud, conceal it, and convert the fraudulent actions to personal gain?
2. Good internal controls require that the custody, recording, and authorization functions be separated. Explain which of those functions Guisti had and how the failure to segregate them facilitated the fraud.
3. Identify the preventive, detective, and corrective controls at GPD&T, and discuss whether they were effective.
4. Explain the pressures, opportunities, and rationalizations that were present in the Guisti fraud.
5. Discuss how Greater Providence Deposit & Trust might improve its control procedures over the disbursement of loan funds to minimize the risk of this type of fraud. In what way does this case indicate a lack of proper segregation of duties?

Source: John Kostrezewa, "Charge: Embezzlement," *Providence Journal-Bulletin* (July 31, 1988): F-1.