



ASSOCIATION OF CREDIT UNION AUDIT AND RISK PROFESSIONALS

Insider Fraud: When the Unexpected Strikes

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Headlines

- CEO imprisoned 6 years for \$250k embezzlement
- Credit Counselor jailed for stealing \$400k from members
- Branch Clerk stole \$600k
- Branch Manager jailed in \$430k embezzlement
- Former CU exec convicted in \$1.5M loan scheme
- Brinks employee embezzles over \$1M
- Teller jailed 3 years for \$200k theft
- NCUA bans Teller who stole \$625k in “C-Note Sandwiches”

Headlines

- Accounting Clerk stole \$800k from credit union
- Lending Chief convicted of \$350k loan scam
- Manager stole to give herself pay raise
- NCUA probes \$6M fraud in credit union failure
- Branch Manager jailed 5 years for \$275k embezzlement
- Credit union executive jailed for \$1M embezzlement
- CEO guilty of \$2M credit union theft



Overview

Objectives

- Types of Fraud
- Cost & Perpetrators of Fraud
- Fraud Examples
- How to Prevent & Detect Fraud



Types of Fraud

Types of Fraud

- Typically, two primary types of fraud
 - Financial reporting fraud
 - Not pervasive throughout the industry & includes:
 - Lack of timely recording of loan losses
 - Manipulation of loan delinquency
 - Embezzlement or theft
 - Most common type of fraud

Types of Fraud

- Embezzlement
 - Common fraud targets
 - Change funds
 - Bank accounts
 - Loans
 - Investments
 - Member accounts – elderly

Types of Fraud

- Two common elements after detection
 - Direct losses resulting from loss of funds
 - Indirect losses – reputation risk



Cost & Perpetrators of Fraud

Fraud Facts

- Association of Certified Fraud Examiners
 - Median Average Fraud Loss \$117,000 before detection
 - 12 months before caught
 - Longer tenured employees lead to higher fraud losses
 - 10 years or more of service – median loss of \$250,000
 - Mean is \$2.4 million
 - Employees in year 1 – median loss \$50,000
 - Mean is \$1.5 million

Who Commits Fraud?

- Employees – 37%
 - MSRs, Financial Analysts, Loan Officers
- Manager – 39%
 - Branch Managers, Finance Director, VPs (size)
- Owner/Executive – 23%
 - C suite, potentially VPs

Average Losses by Position

- Employees - \$50,000
- Manager - \$125,000
- Owner/Executive - \$337,000

Fraud by Tenure

- Less than 1 year – 9%
 - 1 to 5 years – 47%
 - 6 to 10 years – 25%
 - More than 10 years – 20%
-
- Fraud triangle
 - Opportunity
 - Rationalization
 - Financial pressure



Fraud Triangle

- Needs/Financial Pressures
 - Financial difficulties
 - Job loss
 - Future uncertainties
 - Maintenance of increased lifestyle (BOAT)
 - Disruption in family life (death, sickness)
 - Medical bills
 - Alcohol, gambling, addictions

Fraud Triangle

- Needs/Financial Pressures
 - Pressure to meet target & incentive goals
 - ROA
 - Net income
 - Net worth
 - Loans to shares
 - Charge-offs
 - Delinquency
 - Growth

Fraud Triangle

- Opportunity
 - Poor Internal Controls

Segregation of Duties!!

Segregation of Duties

- Examples of a lack thereof
 - Accounting personnel w/ access to member & GL accounts
 - Wire transfer – originate, verify & transmit
 - Loan officers approving & disbursing
 - Collection officers posting loan payments
 - Lack of dual controls over vault cash

Fraud Triangle

- Opportunity
 - Incomplete accounting reconciliations
 - Bank accounts
 - Other general ledger accounts
 - Lack of review of file maintenance reports

Long-term employees
trusted unconditionally



Fraud Examples

Examples of Fraud #1

CEO imprisoned 6 years for \$250k embezzlement:

- CEO was manager and sole employee
- Handled daily operations without direct supervision
- Stole funds over 4 years
- Funded fake loans using real and fake members
- Deposited proceeds to her own account

Examples of Fraud #1

What Went Wrong:

- \$9M in assets with 1 employee
 - Average for CUs (\$10-\$50M), 1 for every \$3M
- Manager could approve/disburse same loans
 - Without oversight from Supervisory Committee
- Manager could open new member accounts
 - Without oversight again

Examples of Fraud #1

How to Prevent:

- Supervisory Committee review of mbr docs to include:
 - Driver's license
 - Credit reports
 - And be done at least quarterly on all new accounts
- Supervisory Committee review of loan docs to include:
 - Validating disbursement of proceeds:
 - Check disbursement or deposit to member account

Examples of Fraud #2

Branch Manager jailed in \$430k embezzlement:

- Siphoned funds from accounts of VA members who:
 - Not receiving monthly statements
 - Lived out of town
 - Ill or near death
 - Provided falsified records from handwritten ledger
 - Also stole directly from vault
 - Worked branch with son and would indicate
- Doeren Maynard & Co. P.A. already counted

Examples of Fraud #2

What Went Wrong:

- Two branch employees were family members
 - Mother and son (parental power)
- Members were not receiving statements
- Cash counts not conducted by Committee or Board
 - Independent of branch employees ever

Examples of Fraud #2

How to Prevent:

- Performance of cash counts by non-branch personnel
- Review members classified as “no-mail”
- Ensure all other members receiving statements
- Review for inappropriate transactions

Examples of Fraud #3

NCUA probes \$6M fraud in credit union failure:

- Credit union became insolvent
- Elaborate scheme that:
 - Falsified CDs, investment & bank statements
- Institution liquidated due to fraud

Examples of Fraud #3

What Went Wrong:

- Investment tasks limited to one individual
 - Authorization
 - Execution
 - Recording
 - Reconciliation
- Access and control over bank accounts provided to CEO

Examples of Fraud #3

How to Prevent:

- Segregation of duties, no one person can do it all
 - 2nd employee responsible for execution of purchase
- Supervisory Committee review of transactions on a periodic basis (annually)

Examples of Fraud #4

Credit union executive jailed for \$1M embezzlement:

- EVP wrote checks off member accounts to pay:
 - Mortgage
 - Income taxes
 - Travel expenses
 - RV trailer
- Manipulated member accounts to hide scheme
- Post to member accounts then reverse after reporting date

Examples of Fraud #4

What Went Wrong:

- High level executive had access to post & impact member accounts
- Lack of substantial review of income statement fluctuations

Examples of Fraud #4

How to Prevent:

- Senior management access limited to post only
- Detailed monthly review of:
 - Financial statements
 - Income statement fluctuations

Examples of Fraud #5

CEO guilty of \$2M credit union theft:

- Complex money laundering scheme involving:
 - Forged checks
 - Multiple aliases
- Embezzled funds for her personal use
- Used some funds on others and “didn’t live an extravagant life”

Examples of Fraud #5

What Went Wrong:

- 1 employee branch location
- No oversight from the Board of Directors (BOD)
- Long tenured employee – trusted by the BOD

Examples of Fraud #5

How to Prevent:

- Regular audits by the BOD of new member accounts

General Prevention

**Board of Directors,
Supervisory Committees, &
Internal Audit need to Stay
Active!!!**

General Prevention

- BOD/SC includes at least 1 financial expert
- BOD, SC, or IA perform regular reviews or engage outside external audit firm
- External firm performs independent reviews to serve as the control point when internal staffing can not provide segregation of duties



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Thank You!