

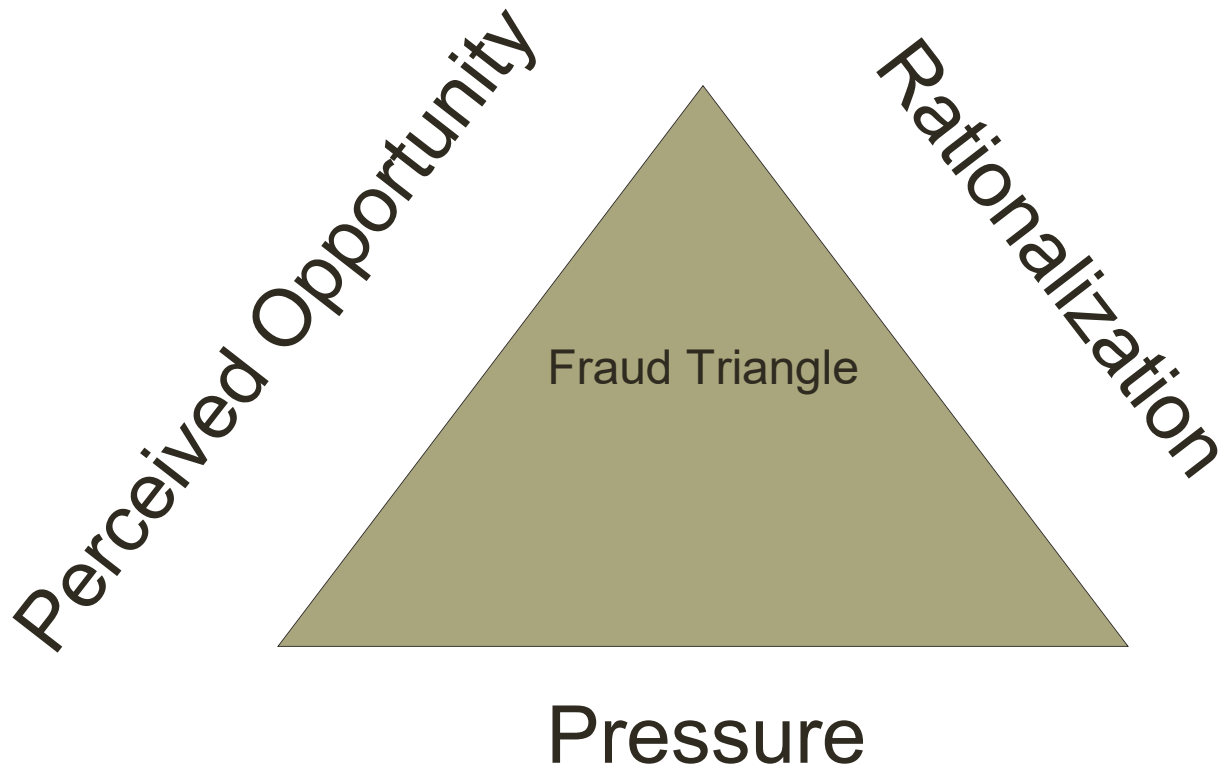
Ripped from the Headlines....Recent Internal Frauds

Susan M. Landauer, CPA
Partner
Forensic Accounting Services Group, LLP
slandauer@forensicasg.com

Key Points

- Why are they committing fraud?
- What are the types of internal frauds?
- What are the red flags of internal frauds?
- How do we prevent these frauds?

The Fraud Triangle



Fraud Triangle Defined

- When asked why they stole when they did, as opportunity had been apparent before:
 - “There was no need for it like there was at this time.”
 - “The idea never entered my head.”
 - “I thought it was dishonest then, but this time it did not seem dishonest at first.”

Pressures That Cause Fraud

- Crisis in personal life
- Financial pressures
- Gambling, drugs or other vices
- Life situation changes
- Career or job pressures
- Peers / family
- GREED

Rationalizations

- They owe me.
- No one will notice or get hurt.
- I deserve it.
- I see others doing it, why not?
- I need it more than they do.
- Subtle – comes when least expected!
- Conscious decision to place needs above needs of others.
 - In summary – can always be rationalized!

Opportunities - Internal

- Lack of segregation of duties
- Lack of internal controls
- Lack of appropriate system of approval hierarchy
- Overrides not controlled
- Lack of vacation policies
- Attitude of management / employees
- Lack of understanding of processes

Fraud By Type for Financial Services

Type of Fraud	#	%
Corruption	83	36.2
Cash on Hand	48	21.0
Cash Larceny	29	12.7
Billing	29	12.7
Non-Cash	24	10.5
Financial Statement Fraud	22	9.6
Skimming	21	9.2
Check Tampering	21	9.2
Expense Reimbursements	13	5.7
Disbursements / Payroll	12	5.2

Corruption

- Employees use their influence in the business to gain a direct or indirect benefit, in a way that is a violation to their employer
 - Bribery, kickbacks, conflicts of interest

Headline – Fake Loan Scam

- VP of business banking authorized millions in business loans in exchange for kickbacks from a real estate developer
- \$4 million loan fraud conspiracy
- He approved loans far in excess of the cu's loan policies
- Received \$134,773 in kickbacks
- Paid to a front company
- Also received free use of a home constructed by the developer's company
- Free use of a BMW

Corruption

Internal Controls:

1. Annual ethic statement
2. Training of employees
3. Review of employee accounts
4. Rotation of duties in loan and purchasing departments
5. What else? _____

Cash on Hand

- Stealing of money from teller drawers or vault
- Red Flags:
 - Multiple cash short and over entries

Credit Union VP Gets 30 Months

- Stole \$826,000 from CU over 14 years
- Purchased toys for her husband
- First – took cash from her drawer or vault – false tickets
- Also issued over the counter checks, for less than \$10,000, making them appear as though they came from members accounts
- She created fake cash-in tickets for her drawer and the vault
- Whenever she was audited – she created a transfer entry between her drawer and the vault after the first one was counted and before the next one was counted

Headline – CU Head Teller Confesses to Theft via Text Message

- In the early morning hours, then head teller sent a text to his supervisor
- He admitted that he stole more than \$100,000 and replaced it with so-called Hollywood prop money
- He did this on a Saturday, and texted his boss before the branch opened on Monday.
- Was not found – believed he ran to Mexico

Long Time CEO steals \$1.9 million

- Stolen from cu vault
- 433 times in 17 years she stuffed money in her pockets
- Then recorded the withdrawal through the accounting system
- Looked like it was transferred to corporate account
- She did not reconcile corporate account, so had to reduce the account when time to reconcile

Cash on Hand

Internal Controls:

1. Dual control over cash shipments received / ATM replenishment.
2. Dual control over vault access.
3. Surprise cash counts
4. Full reconciliation of cash to general ledger – including tickets for sales and purchases
5. Review of all non traditional entries to cash

Cash Larceny

Stolen *after* money is on books -
embezzlement

- Red Flags:
 - Reconciliations late or contain many items
 - Large deposits in transit
 - Large write-offs
 - Cash short and over excessive
 - Irregular entries to cash account
 - Entries to dormant accounts
 - Large # of no-mail accounts

Headlines...CEO and MSR

- President / CEO and a customer service rep – guilty of stealing \$2 million from CU
- Wrote checks from the credit union's financial accounts to pay for family personal expenses
- Created negative balances – then altered books to show fake deposits, bringing balances back to positive

Headlines – Mail Room Clerk

- Embezzled \$5.4 million from a \$7.7 billion CU
- His job in the mailroom included the issuing of checks to replenish the postage meter
- He would issue the checks every week for the postage meter
- Would also issue a check to buy large amounts of postage stamps
- Would ship the stamps to Ben Art Stamp Co and be paid by check
- Between 2007 and 2017, Ben Art paid him more than \$3.6 million

Headline - \$670,000 stolen from dormant accounts

- Shifted money between 16 dormant or rarely used high balance accounts
- Hid it from examiners by continually shifting the funds
- Received 51 months in jail – ordered to pay \$13,066 monthly until debt paid off

Cash Larceny

Internal Controls:

1. Controls over dormant accounts / no-mails.
2. Reconciliations of all internal accounts.
3. Clear segregation of duties in loan processing area.
4. Clear definitions of stale items.
5. Review of employee accounts.

Cash Larceny

Internal controls:

6. Segregation of collateral valuation from loan area.
7. Data mining:
 - a) Address T/B review - PO Boxes
 - b) Debit entries to expense accounts – source of entries
 - c) Entries made to dormant accounts
 - d) Non-financial transaction report

Billing

- Types:
 - Issuing a false payment – shell companies
 - Inflated invoices – falsified / collusion
 - Personal purchases disguised
- Red flags:
 - Changes in purchasing patterns
 - Increase in new vendor usage
 - Increase in expense categories
 - Checks going to employee addresses

Headline: Feds go after Former CU CEO

- Multimillion – Dollar Embezzlement
- Ordered to repay \$9,890,375 to Municipal Credit Union
- Employees were afraid to challenge him
 - Follow his instructions or risk getting fired
 - Call him Mr. Wong only
- He was an addict – gambling and drugs
 - Spent \$5.5 million in NY lottery tickets
 - Daily drug cocktail at his desk of opiates, hydrocodone pills, and a codeine – laced syrup
- Set a tone at the top that failed to value compliance, ethics and morals; rewarded those that kept their heads down and traded favors

Mr. Wong continued...

- Presented phony invoices for dental work he never had done
- \$7.7 million in cash payments for long-term disability payments, which he was not entitled to
- \$2 million in fake tax reimbursement payments
- Fake repair bills for luxury cars
- Educational, housing and living expenses for relatives
- Cash advances – tens of thousands
- \$2 million in ATM withdrawals
- Hundreds of thousands in cash payments in place of 320 sick days he was not entitled to

Mr. Wong....

- Got drugs from a supervisory committee member in exchange for funneling hundreds of thousands of dollars to the committee member's company
- Sentenced to more than five years in prison – 66 months
- Three years supervised release
- Forfeit / restitution of \$9.8 million

CEO Sentenced for Embezzlement

- Set up an Amazon vendor account under his wife's name
- Purchased supplies on his own, and then resold them through his wife's vendor account
- Used his corporate credit card for the purchases
- CU could only account for 15% of the total purchases on his card
- Purchased 2 battery operated towers for computers for about \$200 – resold them to CU for more than \$900
- Got 2 years in prison and restitution of \$251,438 + 5 years supervised release

Billing

Internal Controls:

1. Segregation of duties over new vendor approval, set-up, purchasing, authorization, receiving and recording.
2. Monitor changes to vendor database.
3. Segregate returned checks from A/P function.
4. Data mining – run vendor addresses against employee payroll database.
5. Conflict of Interest Policy
6. Comparing prices of goods and services to outside vendors.

Non-Cash

- Includes:
 - Theft of proprietary information
 - Use of assets for personal use
- Red Flags:
 - Inventory shrinkage
 - Increase in identity theft amongst customers

Headlines – Former Lending Officer

- Pleads guilty to aggravated ID theft
- Used the identity of a cu colleague and former college roommates
- Embezzled over \$800,000 using the stolen information
- Withdrew money from dormant and active member accounts
- Paid off personal credit cards and mortgages
- Used majority of the money to pay off American Express purchases of online gaming – over \$500,000
- Discovered when members started complaining about the withdrawals

Tampa CU's in legal fight over stolen member data, trade secrets

- A former credit union employee sent files to her former credit union boss, who had taken a job with competition
- Sent lending strategies, internal loan applications, personal information on members, historical loan ratio and performance reports, bankruptcy and collection files and other documents

Non - Cash Larceny

Internal Controls:

1. Encryption of any items downloaded.
2. Controls in check processing area.
3. Clear definition of what is determined confidential in fraud policy.
4. Monitoring of attachments to e-mails

Financial Statement Fraud

- The intentional misstatement or omission of information considered material to the financial condition of the institution.
 - Non-reporting of expenses
 - Inflation of revenues
 - Inflation of assets
 - Under-reporting of liabilities

Headlines – CFO files false call reports

- 75 year old CFO of cu filed false quarterly call reports
- Overstated net worth of cu – made it appear adequately capitalized, when was really in bad shape
- Plead guilty

Financial Statement Fraud

Internal Controls:

1. Limitations of access for entries to the general ledger.
2. Review of key information used to compile the financial statements and call reports.
3. Use of external auditors to perform annual audit.
4. Comparison of credit unions financials to peer group (ncua.gov)

Skimming

- Money is stolen *before* recorded on books
- Types:
 - Lapping
 - Sales Skimming
 - Receivable Skimming
- Red Flags:
 - Increase in customer complaints
 - Large write-offs
 - Untimely reconciliations / many items
 - Interest Income not reasonable

Nelson Lapped!

- IT manager had a \$15,000 bridge loan for moving expenses
- He needed to pay it back or be fired
- He was the chief programmer for the FI; had access to member data
- Opened an account under his elderly uncle
- Located a member's account that he could withdraw \$15,000 out of. Took it out of the "ending balance" field on the statement
- Transferred the money to his uncle's account, moved it to his own
- Statements were printed throughout the month – so he just rolled the \$15,000 through member accounts that did not have a statement on a 29 day schedule
- Failed in February, had ballooned to \$150,000

Skimming

Internal Controls:

1. Customer complaints handled independently from operations.
2. Surprise counts of consignment items and cash drawers.
3. Dual controls over mail opening / ACH processing.
4. Mailing of statements independent.
5. Interest income reasonability.

Check Tampering

Stealing or altering of a check

- Red flags:
 - Vendor complaints
 - Customer complaints
 - Large number of outstanding checks
 - Checks clearing not in system

CEO stole \$1 million

- Used the hidden transaction feature at the credit union
 - If an accidental transaction occurs, it can be hidden, so member does not see it
- She would alter the amounts due on invoices to reflect a higher amount due by the cu
- CU cut a check for the larger amount, she processed the check, paid the actual lower amount that was due and then deposited the difference into her account
- Manually processed the payment and then checked off the hidden transaction box on system
- Paid off credit cards, buy a car and truck, timeshare in Florida, a camper, clothes, jewelry, cruises and trips with her husband

Former NCUA examiner, now CEO steals \$40 million

- Knew how to steal, because he knew what examiners look for
- Removed funds out of the cu by altering the payees on the cu checks
- Would issue checks without a payee out of member's accounts
- Funds to cover the checks were withdrawn from a share account that belonged to the cu and used as a clearing account
- Would then type in his own name on the check – no payee was in DP system
- Gambled most of the money, traveled by private jet, expensive watches, gave wife weekly allowance of \$5,000, a Porsche and a Tesla, opened a café, and purchased real estate

Check Tampering

Internal Controls:

1. Independent reconciliation of accounts.
2. Check processing – all mailed out from a/p, not returned to cost center.
3. Customer complaints handled outside of operations.

Expense Reimbursements

Types:

- Airfare scams
- Personal expenditures
- Duplicate reimbursement

Red flags:

- Increase in expenditures
- Undocumented expenses
- Inconsistent expenses

Anyone have a headline?

- Dr. Kite....

Expense Reimbursements

Internal Controls:

1. Receipts needed
2. Review for any direct pay situations.
3. Proper review of expense reports.
4. Review for duplicate reimbursement from multiple organizations.

Disbursements

To hide theft of cash – falsifying register

- Reversal of fees
- Kiting
- Red flags:
 - Reduction in fee income
 - Multiple transactions under a teller code

Employee Charged with \$400,000 theft

- Employee embezzled more than \$415,000 from the CU
- She manipulated computer records and altered the “cash-outs” and dividends paid to members

Disbursements

Internal Controls:

1. Oversight on fee reversals.
2. Velocity of funds for employee accounts.
3. Review of reversals by teller code.

Payroll

- Types:
 - Ghost employees
 - Hours inflated
 - Commission schemes
- Red flags:
 - Expense out of line
 - Deposits going to same DDA account

Any headlines you know of?

- Commission based problems anywhere....

Payroll

Internal Controls:

1. Limit access to payroll system.
2. Data mining –
 - a) Look at DDA's where pay is being deposited.
 - b) Review employees against system access records / security records.

QUESTIONS?



Contact me: Susan Landauer
slandauer@forensicascg.com