

Internal Fraud Investigations

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ViClarity

Agenda

- Internal Fraud Background
- How to Detect Internal Fraud
- What to Do When You Find Potential Internal Fraud
- Internal Fraud Cases





Internal Fraud Background



National Credit Union Administration

- In the most recent NCUA postmortem review as of 2021, 13 of 16 failed credit unions cited insider fraud as a contributor to the failure
- The Share Insurance Fund suffered losses of \$146.8 million from insider fraud



National Credit Union Administration

Most Common Types of CU Internal Fraud:

- Loan Fraud
- Investment Fraud
- Share & Member Account Fraud
- General Ledger Manipulation

How is Internal Fraud Conducted?

Fraudulent Financial Statements

- Intentional violation of policies, internal controls, regulations, or procedures
- Manipulating accounts, documents, records, forgeries, etc.

Misappropriation of Assets

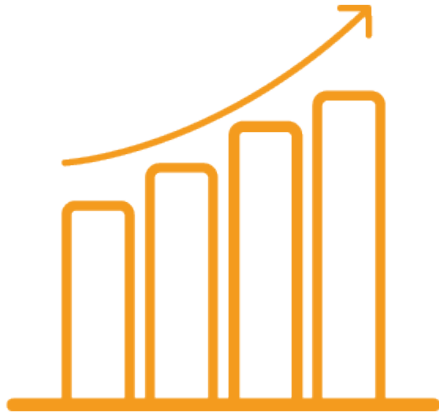
- Theft
- Check kiting
- Fake invoices
- Fictitious fee refunds
- Ghost employees or straw borrowers
- Manipulated suspense accounts
- Unrecorded ACH transactions or CU check disbursements

Corruption

- Preferential treatment for gain
- Bribes or kickbacks
- Unauthorized pay advances, overtime, or reimbursements



Areas With Increased Fraud Risk



Sales



Accounting



Positions of Power



National Credit Union Administration

Tips to Deter Internal Fraud:

- Establish Fraud Policy
- Conduct Fraud Awareness Training
- Bond Employees & Perform Background Checks (initial and ongoing)
- Anti-Nepotism Policies
- Internal Controls



How to Detect Internal Fraud

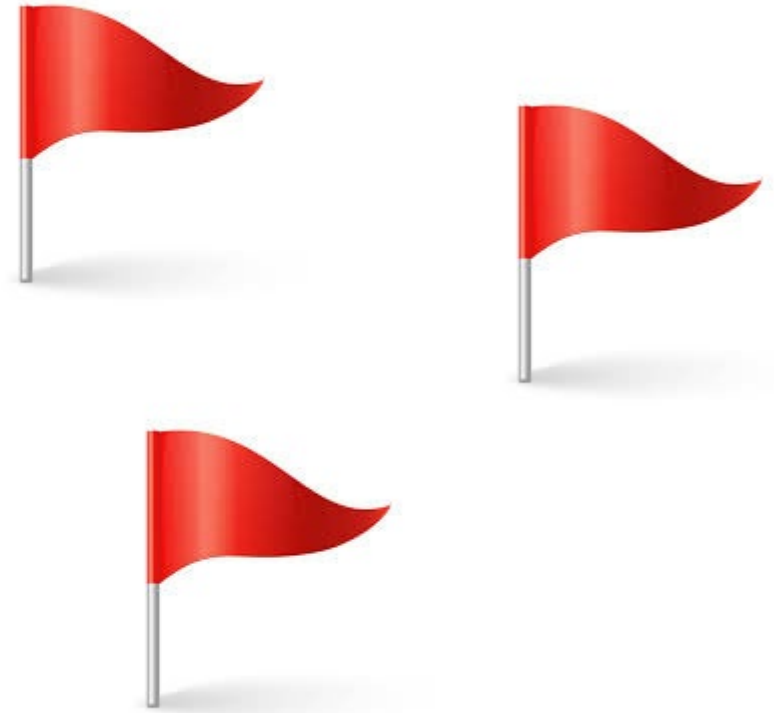
3 Most Common Methods of Detecting Internal Fraud

- Hotline Tips
- Internal & External Audits
- By Accident



Potential Red Flags

- Employee Lifestyle Changes
- Significant Personal Debt
- Behavior Changes
- Refusal to Take Vacations



What You Should Look Out For

Insider Transactions

- Involvement with businesses that receive financing through the credit union
- Receiving “perks” from the credit union, such as expensive vehicles, housing, boats, etc.
- Authorizing expenses such as landscaping or remodeling that appear justified, but no work is actually done
- Receiving or providing special favors in return for business
- Having extreme debt that appears to require most, if not all, the individual’s salary
- Frequently on past due loan list but not on report to the Board
- Frequently overdrawn accounts with deposits from loans or undisclosed sources to bring it positive
- Regularly strays from defined process for getting loan documents signed, handling disbursements, or past due payments

What You Should Look Out For

Corporate Culture/Ethics

- No Bank Bribery, Fraud, or Whistleblower Policy
- Policies controlled by one or two members of management
- CEO should not have control of internal and external auditors
- Abrupt request by insider to change auditors or Legal Counsel
- Insider who tries to control what groups are audited
- Not allowing employees to talk to examiners/auditors
- Be wary of not placing importance on expense account reviews

Real Estate Transactions

- Unusually large number of loan exceptions to bypass the normal documentation
- Close relationships between the borrower, builder, appraiser, inspector, and lender
- Independent reviews of outside appraisers never done

Wire Transfers

- No segregation between who can initiate and approve a wire
- Frequent overrides of approval authority
- Intentionally splitting wires to avoid approval authority

What You Should Look Out For

Credit and Debit Card Issuance

- Lack of separation between card issuing function and PIN
- Not monitoring unissued cards
- Returned mail isn't monitored
- Review credit limit increases and name and address changes

Miscellaneous

- Circumventing policies and procedures routinely
- Frequently recurring exceptions
- Weak separation of duties
- Dominant figure allowed to exert influence without restraint
- Lack of accountability
- Cash on hand frequently exceeds established limits
- Not breaking down cash bundles in vault

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What to Do When You Find Potential Internal Fraud

Fraud Investigation Process

- Assess the Situation
- Plan the Investigation
- Review Records
- Conduct Interviews
- Analyze the Evidence
- Write the Report



Assess the Situation

- What's the scope?
- Determine who needs to be involved – independence is key
- Should the investigation be internal or external or both?
- Was the report made in good faith?
- Was a law or policy broken and what's the severity of the accusation?
- Who is being accused?
- Has the accused had similar accusations in the past?
- Have there been any red flags with the accused?
- What's the reputational risk?
- Consider suspending the accused with pay while you investigate



Plan the Investigation

- What's your timeline for the review? Don't rush it!
- What do you already know and what do you still need to find out?
- Who will you interview?
 - Start with the reporter (if there is one), the manager, direct colleagues, potentially friends and family
- What groups need involved?
 - Potentially HR, management, accounting, security, IT, the board, legal, regulators, etc.
- What documents need reviewed?
- Who will be assigned tasks?
- Who will need to be notified of the results?
 - The board, regulators, members, etc.



Review Records

- This may include documents, photos, videos, receipts, invoices, etc.
- Review emails and chat histories of the accused
 - Ensure your policies are clear that you have access to their work email and chats at anytime
- Review personnel files of accused
 - Look for performance decline, unused vacation time, previous infractions or investigations
- Review logins to CU systems – especially in cases of remote employees
- Retain copies of all documents reviewed



Conduct Interviews

- Have more than one person present
 - May want to include HR
- State what to expect in the interview
- Let interviewees know that whenever possible, their responses will be kept confidential, and they will be protected from retaliation
- Ask open-ended questions and avoid leading the interviewee
- Ask questions you already know the answers to as well
- Remain impartial and keep emotions in check



Conduct Interviews (cont.)

- Start with background questions
 - You learn and build rapport
- Ask questions until you understand
 - Revisit the subject – provides clarity but also may reveal inconsistencies
- Talk about any concerns they have with their role at the CU
- Discuss areas where they think the CU is vulnerable to fraud
- Finally, dive into specific questions about the suspected fraud
- Keep them talking!



Analyze Evidence

- Only use evidence if it's relevant, specific, and concrete
 - Avoid items that are out of scope
- Do you have enough evidence to draw a conclusion?
- Keep all evidence secure



Write the Report

- Avoid opinions and judgments
- Stick to the facts
- Use direct quotes when possible
- Don't use inflammatory language



Follow-Up

- May want to file an insurance claim depending on the loss
- Conduct a “lessons learned” meeting
 - What did the CU learn and how could this be prevented in the future?
- Update policies/procedures and internal controls as necessary



Lessons Learned



Recent Case Example

- ACH Coordinator sentenced to prison for role in \$2 million wire fraud at an Indiana CU
- Reviewed accounts to obtain balances and then provided account information to his co-conspirators to make transfers
- Paid \$100K in cash kickbacks for his role

Questions?



Contact us or visit our site to learn more about ViClarity!

Thank you for attending!

Resources

- <https://ncua.gov/regulation-supervision/manuals-guides/lessons-learned-postmortems-material-loss-reviews>
- <https://ncua.gov/newsroom/ncua-report/2016/help-deter-detect-and-report-insider-fraud>
- <https://www.caseiq.com/resources/how-to-conduct-a-fraud-investigation-the-complete-guide/>
- <https://www.fdic.gov/resources/supervision-and-examinations/examination-policies-manual/section9-1.pdf>
- <https://www.whistleblowers.org/fraud-triangle/#:~:text=According%20to%20Albrecht%2C%20the%20fraud,being%20inconsistent%20with%20one's%20values.%E2%80%9D>
- <https://www.corporatecomplianceinsights.com/the-best-questions-to-ask-during-a-fraud-interview/>
- <https://www.jdsupra.com/legalnews/internal-company-fraud-investigations-5962170/>