

# NACUSAC 2023 Annual Conference and Expo Fraud: Prevent, Detect and Deter

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Stephen Kwock  
Kwock & Company CPAS  
(Honolulu, Hawaii)



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## Environment of Fraud 2023

- NCUA Supervisory Priorities identifies Fraud as a concern in 2023.
- Fraud transactions are alike at large and small CUs
- Fraud events can be devastating and it hurts smaller CUs more
- Can be grave for small CUs and may be huge Reputation Risk for large CUs.



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# FRAUD STORIES

## CBS Employees CU

- CBS Credit Union was left the insolvent, merged into another CU
  - \$40 million fraud scheme by the manager of 30 years
  - Online payments to himself, forging signature of another employee on CU checks to himself.
  - \$100,000 watches, buy a new car every year, impress women half his age with trips on private jets to international vacation resorts, Tiffany jewelry and gambling parties
  - Discovered by a fellow staff member
  - 30 years prior to working at CU
  - 14 years in prison



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# FRAUD STORIES

## A Credit Union under \$100 Million in Assets

- Three separate frauds by 3 different staff employee (All received prison time). Total Loss - \$1,022,965
  - CEO/Manager – Loss - \$182,980.26
    - Fraudulent Loans
    - Advancing due dates on loans to avoid DQ status
    - Loan lapping (Approving a loan to pay off a previously made fraudulent loan.
    - Giving an \$18,251 Subaru repossessed auto loan to daughter
    - Purchased laptop with CU funds and gave laptop to daughter
  - Loan Officer – Loss \$650,000
    - Loan officer notified VISA that her balance was paid but CU did not receive pmt. VISA loan loss of \$360K
    - Made fictitious loans to family members and related parties to cover the VISA loan pmt - Loss – 290K
  - Teller - \$188,920.59
    - Cash advances from VISA Card
    - Personal charges on VISA Card



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# FRAUD STORIES

## Indirect Auto Lending Fraud

- Indirect Auto Loans
  - First time borrowers (with no credit score)
  - Loans over auto factory's MSRP
  - Reselling of repossessed autos by the same auto dealer resulting in CU making a loan to borrower purchasing the repossessed auto but not charging off the first loans. Resulting in duplicate vehicle identification numbers (VINS) securing same auto at the same CU



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# FRAUD STORIES

## Other

- Investment rollovers
- Employee increases own personal LOC limit



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## Definition of Fraud

(Source: Association of Certified Fraud Examiners)

- Fraud is an immoral activity **intentionally** adept in order to gain personal benefit or objective by **deceiving** the others or at the risk of others.
- In legal aspect it comes in both civil wrong and criminal wrong. In case of civil wrong, like breach of contract or failure to perform specific performance, the fraud perpetrator may be compelled to pay monetary compensation.
- In case of criminal wrong, like bank fraud, insurance fraud and forgery, he may be sentenced to **jail** or monetary compensation or both.



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## Definition of Embezzlement

(Source: Association of Certified Fraud Examiners)

- Embezzlement is an act of dishonesty and deceit with the intention of illegally **withholding the entrusted assets** of someone without his permission.
- It is a kind of **financial fraud** in which a person who is entrusted with accounts, monies, or other valuable assets by someone and he refused to return the same on demand.
- There is no physical violence in embezzlement that's why it is called as **white-collar crime**. It also comes in both civil wrong and criminal wrong. Mostly its punishment are according to civil law.



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## Characteristics of Financial Statement Fraud

- Fraud is an **intentional** act that results in a material misstatement in your financial statement
- Misstatement arising from **fraudulent financial reporting**
- Misstatements arising from **misappropriation of assets** (Theft or Defalcation)



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## Insider Fraud is Omnipresent

- Common themes from those who have stole from Credit unions:
  - Their intention was to borrow and pay it back
  - ...But, could not pay stolen funds back
  - Didn't believe they would get caught
  - Incentive, Opportunity and Rationalization (The Fraud Triangle)
  - First time offenders



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## Types of Fraud Techniques of Employee Fraud

- Check kiting and Lapping
- Fictitious loans and repayment transactions
- Fictitious member accounts
- Fictitious transactions dormant, no-mail and closed accounts
- Charge card fraud: Unauthorized charges
- Stealing physical assets; small and large
- Ghost employee schemes
- Invoices for payments from fictitious companies
- Collusion among management and third parties to steal
- Stealing your credit union's Investments



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## Embezzlement Schemes

- False accounting entries
- Unauthorized withdrawals
- Unauthorized disbursements of funds to outsiders
- Paying personal expenses from CU funds
- Moving money from customers' dormant or inactive accounts
- Unauthorized, unrecorded cash payments
- Theft and other unauthorized use of collateral
- Employee incentives can motivate altering of the recordkeeping of the incentives.
- Management overrides to circumvent internal controls



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## Assess Management Overrides

- Generally Accepted Auditing Standards – “Management can perpetrate Fraud because of management’s ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.
- Ensure that your internal or external auditor or a senior level employee is conducting a review to evaluate the overrides performed by management.



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## Conflict of Interest

- A directors receiving personal financial benefit or economic incentive while acting on behalf of the credit union and its members is a conflict of interest.
- Senior management or board member participating in a decision to charge off a loan to their relative or family member is a conflict of interest.



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## *Unintentional Errors are Not Fraud*

- Lending to poor credit worthy members
- Investing in non-federally insured institutions
- Misplacing cash and change fund
- Scams from outsiders of your credit union family
- Claims brought by members of consumer compliance issues
- Poor corporate business decisions



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## Frauds of Large Amounts Can be Devastating

- Material misstatement of financial statements
- Failure and insolvency
- Reputation risk
- Merger



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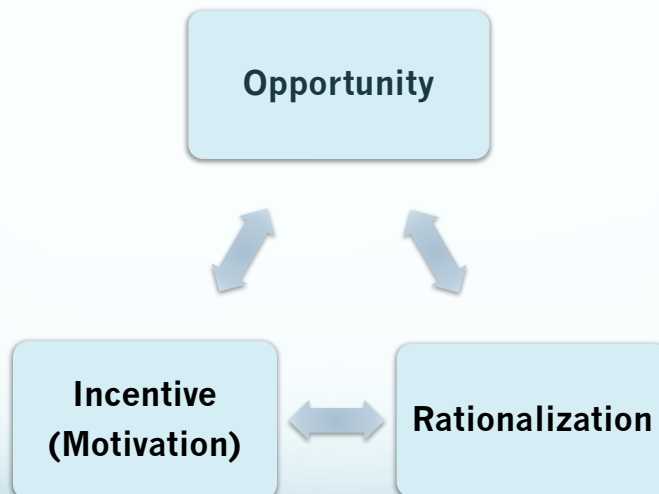


## But... Fraud Won't Happen at Your Credit Union?

- Good Trustworthy Employees?
- Employees read our fraud policies?
- Strong Internal Controls?
- Other reasons fraud won't happen at our CU?

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## Fraud Triangle



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## Who Conducts Fraud?

(Source: ACFE 2021)

- Men represented 73% of all fraud
- Women were responsible for 27% of all frauds
- Owners and executives committed only 23% of all frauds
- Managers committed 39% of all frauds
- Lower-level employees committed 37% of all frauds
- **87% of all perpetrators had no criminal background**

## “Sloppy” Shop Fraud – Red Flags

(source: NCUA)

- Missing records and signature cards
- Accounting records are not balanced
- Manager has outside interest
- Manager delays in providing information
- Members without addresses or SSNs
- Back dated transactions
- Lots of unreconciled items on bank reconciliation
- Nepotism
- Large deposits flowing through an account

## RED FLAGS Behavior Pattern

(Source: ACFE 2021)

- Living beyond their means
- Having known financial difficulties
- Having an unusually close relationship with a member or vendor
- Having control issues, including an unwillingness to share duties
- Known for bullying or intimidation
- Experiencing divorce or other known family problems
- Having a "Wheeler-Dealer" attitude
- Displaying frequent irritability, suspiciousness, or defensiveness
- Having known addictions problems (alcohol, gambling, drugs, etc)
- Frequent complaining about inadequate pay

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## How Do you Keep a Good Employee --- GOOD!

- Remind Frequently and Often during training:
  - Credit Unions are insured by the federal government
  - If caught, there may be consequences
    - FBI = Sends you to prison
    - Insurance = Demand restitution
    - No second chances
    - CU will report all fraud incidences
  - You will be caught!
  - Felony conviction on your record for life
  - Be PROACTIVE and create an ethical environment
  - Help your good employees stay honest employees

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## Deterring Insider Fraud

- **Establish a Fraud Policy (Stand Alone Policy)**
  - Clarify and communicate expectations related to preventing fraud and the of committing fraud.
  - Address whistle-blowing procedures, mandatory and sequential vacation days, employee conduct, and actions a credit union will take if fraud is discovered.
  - Employees should sign the policy annually.
  - The Board of Directors should also consider ongoing fraud awareness training for all employees and volunteers.
  - Post the NCUA Fraud Hotline
- **Ethics Policy (Code of Ethics)**
  - Safety & Soundness, confidentiality, adequate salaries, lawful, moral, etc.
- **Conflict of Interest Policy**
  - Officials and employees should avoid situations where they would derive personal gain from the CU business, other than normal salary, benefits, and permissible, non-preferential loans.
  - No official or employee may receive, directly or indirectly, any commission, fee or other compensation in conjunction with any loan or transaction made by the CU.



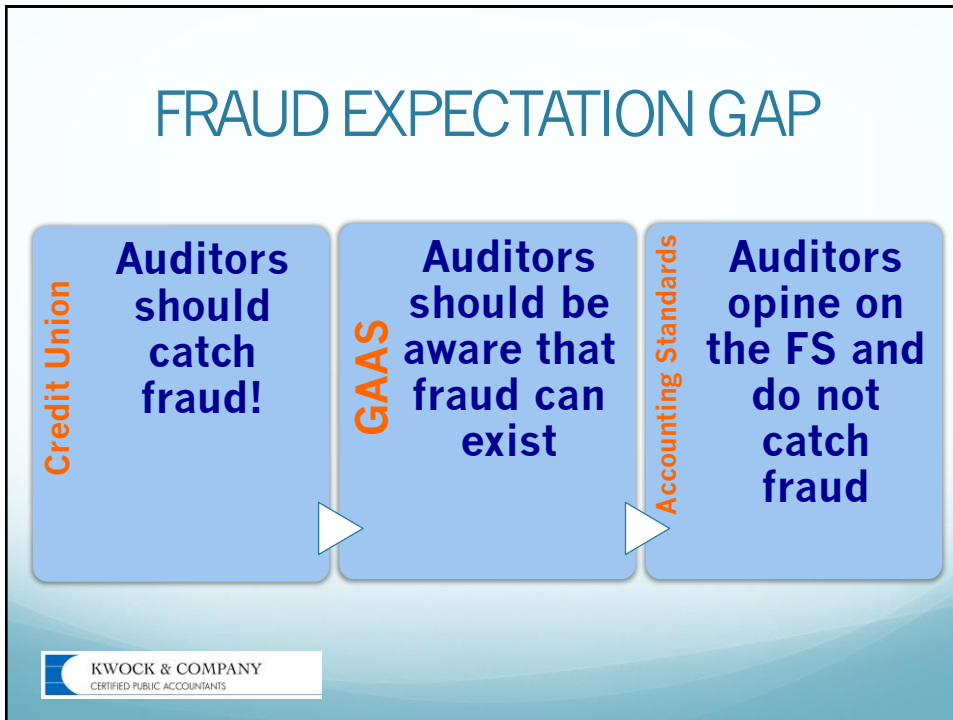
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## Who is Responsible for the Prevention and Detection of Fraud? (Source: AICPA SAS No. 22)

- **The board of directors** and **management** (Those Charged with Governance) are primarily responsible for prevention and detection of fraud.
- The **external auditor** is responsible for obtaining reasonable assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.



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## Can You Rely on Your Examiners or Auditor?

(Source: ACFE 2021)

- Only 4 percent of all frauds were detected by external auditors, according to ACFE Fraud Report.
- 42% of the frauds came from tips (from insiders).
- Employees were responsible for 55% of all the tips.
- Internal auditors detected 16% of all frauds.
- Management review detected 12% of all fraud
- Board of Directors and Supervisory Committee detected ZERO.  
(source: NCUA)

**KWOCK & COMPANY**  
CERTIFIED PUBLIC ACCOUNTANTS

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## Detection Methods of Embezzlement Schemes

- Small fraud amounts: Detected through review of source documents
- Large fraud amounts: Most effective method is an analysis of financial statements, reports and records



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## Future of Detecting Fraud – Teaching the Computer

- Improper payments
  - Building the methodology
    - What's the most improper general ledger account an improper expense is booked to?
    - What anti-fraud test is most common amount the population of these known fraudulent transaction?
    - Are manual payments the norm, or are they outliers? Are there occasions where manual payments are being abused for personal benefit?
  - Data analytics discovers anomalies



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# Future of Detecting Fraud Research Results

- Tagged High-Risk Vendor Payments Often Include the Following Attributes:
  - Payments from vendor who have multiple bank accounts or tax IDs
  - Payments appear to be urgent
    - (Invoice and approval dates close payment dates)
  - Payments occur in high-risk countries
  - Amounts are expensed to general accounts that fall under curated categories of high, medium and low risk categories
  - Payments got to seemingly high-risk expense industries.
    - (Transportation, customs, advertising, etc.)



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## Anti-Fraud Data AI to Detect Fraud (Source: Kona-AI at Integrity Distributed)

Risk Category	Sub Module	Description	% Hit
Controls Validation	Purchase Order	Vendors in POS not in the vendor master	8.69%
Corruption Pattern	Purchase Order	Material description analytics using Key-word list	3.12%
Statistical anomaly	Payments	Identify outlier and unusual payments using statistical anomaly detection by vendor	2.74%
Transaction anomaly	Payments	Duplicate invoice raised having same date, amount, and vendor with a different invoice number	2.20%
Temporal	Invoices	Invoice raised over a weekend/public holiday	2.18%
Transaction anomaly	Invoices	Rounded dollar invoice	1.96%
Control validation	Purchase order	Vendor is missing from the purchase order	1.88%
Transaction anomaly	Purchase order	Duplicate PO based on same vender, material/items within 0-5 days range	1.63%
Conflict of Interest	Payments	Employees with same addresses but different name with payments.	1.63%



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## Limitations on Detection and Prevention of Fraud Risks (Source: NCUA)

It's impossible to eliminate all fraud at your credit union. However, implementation of a robust Fraud Risk Management Program can maximize the likelihood that fraud will be prevented or detected in a timely manner and will create a strong fraud deterrence effect.



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## How to be Proactive

- Inform your employees that your Credit Union has strong internal controls designed to prevent, detect and deter fraud
- Fraud, Ethics, and Conflict of Interest Policies have been approved by the board of directors
- Point out we have cameras (not hidden)
- Express the fraud consequences verbally and in writing in the employee handbook express
- Speak openly about Fraud
- Compensate your employees appropriately
- Supervisory committee and an NCUA Hotline are available to report fraud anonymously



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## Internal Controls designed to Catch Fraud

- Verify member share and loan balances
- Trace and verify large deposits
- Reconcile unreconciled items on the bank reconciliation
- Review and understand investment transactions
- Verify posting of dividends, share draft, and loan payments
- Review file maintenance reports
- Surprise cash counts
- Review accounts with same addresses or SSNs
- Review any institution-related SARs



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## Strong Internal Controls

- Strong internal controls mitigate the opportunity for fraud
- The board of directors sets the tone at the top
- Establish a code of conduct where employees and volunteers need to read and acknowledge by signing



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## COSO FRAMEWORK CUBE



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## CONTROL ENVIRONMENT

The credit union establishes and communicates a Fraud Risk Management Program that demonstrates the expectations of the board of directors and senior management and their commitment to high integrity and ethical values regarding managing fraud risk.

*Board approves policies of:*

- 1) *Ethics Policies*
- 2) *Conflict of Interest Policies*
- 3) *Fraud Policies*

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## RISK ASSESSMENT

The credit union performs comprehensive fraud risk assessments to identify specific fraud schemes and risks, assess their likelihood and significance, evaluate existing fraud control activities, and implement actions to mitigate residual fraud risks.

- 1) *Cybersecurity Threats by Training Employees*
- 2) *Cash, Shares, Loans and Investments, specifically*
- 3) *Reputation Risks*



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## CONTROL ACTIVITIES

The credit union selects, develops and deploys preventive and detective fraud control activities to mitigate the risk of fraud events occurring or not being detected in a timely manner.

***Board Reviews Internal Controls Policies and Procedures Annually:***

- 1) *Segregation of Duties Properly*
- 2) *Bond Employees and Perform Background Checks*
- 3) *Dual controls, computer access controls*
- 4) *Member-account verification,*
- 5) *Surprise cash counts*
- 6) *Timely recordkeeping*
- 7) *Limiting employee access to their own and family accounts*
- 8) *Account verification*
- 9) *Schedule annual discussions with NCUA, IA and auditors on the adequacy of fraud control activities*



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## INFORMATION & COMMUNICATION

The credit union establishes a communication process to obtain information about potential fraud and deploys a coordinated approach to investigate and corrective action to address fraud appropriately and in a timely manner.

*Board needs to establish an open and comfortable environment for employees to report suspicions of fraud to an appropriate employee or volunteer knowing it will be investigated further.*



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## MONITORING ACTIVITIES

The credit union selects, develops, and performs ongoing evaluations to ascertain whether each of the five principles of fraud risk management is present and functioning and communicates Fraud Risk Management Program deficiencies in a timely manner to parties responsible for taking corrective actions, including senior management and the board of directors.

- 1) *Fraud Risk Governance*
- 2) *Fraud Risk Assessment*
- 3) *Fraud Prevention*
- 4) *Fraud Detection*
- 5) *Monitoring and Reporting*



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## What do you need to do when fraud exist?

- File **“Notice of Loss”** to insurance & bond carrier at discovery
- Contact your legal counsel
- Place employee on leave pending review and investigation
- SARs (Suspicious Activity Report)
- Audit the suspicious transaction to calculation loss and conduct verification
- Change or limit access to buildings, data processing systems, eliminate computer access, etc
- FBI: Consider contacting them directly
- Notify NCUA
- Prepare a written script for media, if asked
- File a claim for loss to your insurance carrier



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## Summary of Board Responsibilities

- **Corporate governance: Establish a visible and rigorous fraud governance process**
  - **Written policies and procedures**
  - Design strong operational internal controls to prevent, detect and deter fraud
- **Create a transparent and sound anti-fraud culture**
  - **Train employees about the consequences of fraud**
  - United States Federal offense
  - Will go to federal prison
- **Uncomfortable Dissonance** - An external influence or event that conflicts with your intuition - to motivate a behavioral change.
- **Differential Association** - That we pick up the attitudes and values to engage in white collar crime from spending time around others who engage in misconduct.



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## NCUA Fraud Hotline

- Toll Free: **800-827-9650**
- It's anonymous
- A report is completed by our Office of General Counsel based on the information provided and forwarded immediately to the appropriate regional office. An investigation or inquiry into the allegations is conducted. In the event information provided to the hotline results in a finding of fraudulent or improper conduct, NCUA will take the necessary corrective action.

## Discussion and Questions?

# Mahalo!