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SCHEMES, SCAMS AND SWINDLERS – INTERNAL FRAUD & EMBEZZLEMENT IN FINANCIAL INSTITUTIONS


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WHAT WE WILL COVER TODAY


- Latest internal fraud trends to impact banks, thrifts & credit unions
- Real life examples of schemes & swindles
- Highlight red flags for various fraud schemes
- How to detect & deter those fraud schemes using internal controls & data analytics






2016 ACFE Report to the Nations

FIVE TOP FRAUD TRENDS




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HIGH COST OF FRAUD

- 5% of revenue lost to fraud & abuse each year
- Cost of external assistance with investigation for insurance or criminal purposes
- Higher insurance costs in following year(s)




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HIGH COST OF FRAUD

- Nonmonetary loss can be *more* damaging than the actual monetary loss
 - Loss of reputation
 - Loss of employee morale
 - Loss of productivity due to internal investigation




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BANKING INDUSTRY MOST VICTIMIZED

Industry	Frequency
Banking	16.8%
Government	10.5%
Manufacturing	8.8%

Banking is ALWAYS #1





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RECOVERING FUNDS IS THE EXCEPTION

- In 58.1% of the reported frauds, there was NO recovery
- For the 12% of reported frauds in which there was full recovery, the source of recovery was usually an insurance policy



INSIGHTS ON FIDELITY BONDS

- Likely only chance at meaningful recovery
- Civil litigation to recover losses often fruitless
- Stolen funds squandered or gambled away
- Watch your internal controls ...



PART OF REPLY FROM INSURANCE COMPANY
AFTER FIDELITY BOND CLAIM WAS FILED

Underneath that statement, each application includes the following question in bold typeface (underlined where indicated):

The correspondent account, suspense account, or transit account is used most often by dishonest employees. Are all correspondent accounts, suspense accounts, and transit accounts balanced and reconciled regularly and completely balanced and reconciled by a second person at least monthly?

On the application, the Bank answered "Yes" to this question.



ADDITIONAL REPLY FROM INSURANCE CARRIER


The walkthrough of examples enclosed with your letter states as follows: "Mr. [REDACTED] was responsible for reconciling the general ledger balance to the correspondent bank account statement and therefore the resulting differences were not detected by other bank personnel." This statement suggests that the correspondent account was not completely balanced and reconciled by a second person at least monthly.

[REDACTED] reserves the right to rescind the bond *ab initio* if it is determined that the Bank made misrepresentations or incorrect statements of material facts on the bond application.



MOST FRAUDSTERS HAVE NO PRIOR CRIMINAL HISTORY

- 88.3% of fraudster not previously charged or convicted
 - However, only about 40% of frauds are ever reported due to perceived reputational risk
 - Background checks & reference checks are still important
- Most fraudsters do not take a job with intent to commit fraud, it is often a crime of opportunity



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WHICH ONE LOOKS SUSPICIOUS?

 \$3 million	 \$4.6 million	 \$1.0 million
 \$31 million	 \$20 million	 \$1.1 million



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TIPS ARE TOP METHOD OF DETECTION

- For organizations with hotlines, 47.3% of frauds were detected by tips
- Compared to only 28.2% of frauds for organizations without a hotline

**Figure 23: Detection Method by Region—
United States**

Detection Method	Percent of Cases
Tip	37.0%
Management Review	14.3%
Internal Audit	14.1%
By Accident	7.2%
Account Reconciliation	6.1%
Other	5.5%
Document Examination	4.8%
External Audit	4.0%
Notified by Law Enforcement	2.5%
Surveillance/Monitoring	1.9%
IT Controls	1.5%
Confession	1.2%




SCHEMES & INVESTIGATION EXAMPLES





TOP SCHEMES IN BANKING

- Corruption 37.5%
- Cash on hand 17.9%
- Financial statement fraud 12.0%
- Cash larceny 11.1%
- Noncash schemes 10.6%




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CORRUPTION




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CORRUPTION

- An employee misuses his or her influence in a business transaction in a way that violates his or her duty to the employer in order to gain a direct or indirect benefit
- In the banking industry, the most common form of corruption is the payment of kickbacks to loan officers in return for extensions of credit




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EXAMPLE

- Recent loan fraud
 - Loan officer received money from loan proceeds, payment of his exclusive CC dues & the installation of an in-ground pool with fancy stone patio
 - Identified three involved borrowers
- Red flags
 - Swimming pool/patio & CC membership
 - Officer with bank for six years, lived locally, but has no accounts at employer
 - Loan officer routinely allowed LARGE overdrafts in specific loan customers' accounts
 - Withdrew cash out of borrowers' account to "hand deliver " to them
 - Kept some customer loan files in his office






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RED FLAGS FOR CORRUPTION

- Off-book fraud, so very hard to detect
 - Payments often do not go through the organization's accounting records
 - Payments often paid in cash
- Look for "behavioral" red flags
 - Too close a relationship between loan officer & borrower
 - Credit problems
 - NSF in personal account
 - Asking loan processing to "bend the rules"




ANTI-FRAUD CONTROLS FOR CORRUPTION – LOAN FRAUD

- Within a financial institution, consider segregating the following duties
 - Loan origination
 - Loan application & funding
 - Payment/collection
 - Delinquent loan recovery functions
- Monitor employee accounts





DATA ANALYTICS FOR CORRUPTION

- Unexplained changes to loan maintenance file
 - Evergreening of maturity date
 - Reduction of interest rate
- Repayment of large maturing loans with new smaller loans that do not have to go to the loan committee
- Unstructured data review (read suspected fraudster's email)




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CASH SCHEMES






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CASH SCHEMES



- Any scheme in which the employee steals cash kept on employer's premises or makes disbursements of employer's funds for their personal use
 - Cash larceny
 - Theft of funds recorded in the organization's accounting records
 - Skimming
 - Theft of funds before entry in the organization's accounting records




EXAMPLE

Embezzling through customer cash withdrawals




- Bank customer realized one of his business account balances was less than it should have been
- Reviewed statements for two-year period & found \$51,400 in cash withdrawals he had not made
- Investigation revealed loan officer had embezzled \$130,000 through cash withdrawals from nine friends' accounts or taking cash back on loan payments mailed to his attention







RED FLAGS FOR CASH SCHEMES

- Teller outages
- Unusually high number of voids
- Internal bank accounts that do not reconcile
- Stale items in suspense-type accounts




ANTI-FRAUD CONTROLS FOR CASH SCHEMES

- Segregation of duties
- Dual control
- Surprise audits
 - Cashiers
 - Tellers
 - Vault
- Account reconciliation procedures
- Periodic review of seldom used GL accounts




NONCASH




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NONCASH FRAUD SCHEMES

- Any scheme in which an employee steals or misuses noncash assets of the victim organization
 - Employee extracts customers' personal & account information from a database & then sells that data – identity theft
 - Employee steals employer's competitive data & supplies it to a competitor
 - Common when employees change employers
 - Inappropriate usage of organization assets
 - Often computers or software





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EXAMPLES

- Bank IT manager accessed sensitive customer information & sold it for personal gain
 - IT manager had unrestricted access to all bank applications & databases
 - Full access, not read only
 - Performed computer forensics to determine what databases the IT manager had access & downloaded information from
- Employee accessed sensitive competitive information & lists of high-net-worth private banking clients prior to taking a position with a competitor
 - Performed computer forensics to determine what information was accessed & able to show it was downloaded to a personal flash drive on employee's last day of employment

ANTI-FRAUD CONTROLS FOR NONCASH SCHEMES

- Restrict access to sensitive information
- Automated monitoring of
 - Online transactions & inquiries
 - The date, time & source of online access, especially if the system can be accessed from a WAN or the internet
 - Report generation & downloading, including operational & custom reports or queries, especially those containing customer or account information
 - Emails sent & received & attachment sizes
 - Look for emails to personal accounts
- Tell employees you are monitoring the above




DATA ANALYTICS FOR NONCASH SCHEMES

- If tracked electronically, will often leave evidence of access by
 - Unauthorized users
 - User who have no relevant business purpose for the information/assets
 - Users accessing the information/assets on nonstandard days or at nonstandard times
 - Users downloading or copying information for which they have no relevant business purpose






FINANCIAL STATEMENT FRAUD





FINANCIAL STATEMENT FRAUD



- Financial statement fraud schemes are schemes in which an employee intentionally causes a misstatement or omission of material information in an organization's financial reports
 - Asset/revenue overstatement
 - Liability/expense understatement
 - Timing differences
 - Concealed liabilities & expenses
 - Improper disclosures
- Loan officer knowingly manipulating or allowing the manipulation of the financial statements of borrowers seeking loans from the bank




EXAMPLE

Questionable loans to business associates




- Computer forensics on the loan officer's computer indicated someone using his computer changed financial information submitted by the borrower & used the altered financial statements in support of loan committee presentations for new loans
- All loans for bank kept in central filing repository, except the loans related to this matter, which were kept under lock & key in the loan officer's office







RED FLAGS FOR FINANCIAL STATEMENT FRAUD

- Accounting anomalies
- Unusually rapid revenue &/or profit growth
- Unusually complex transactions
- Significant related party transactions
- Readily noticeable internal control weaknesses
- Noticeably “aggressive” financial actions by senior management
- Domination of management by a single person or small group without compensating controls
- Restrictions on auditors that limit access to people or information



ANTI-FRAUD CONTROLS FOR FINANCIAL STATEMENT FRAUD

- Trend analysis
 - Vertical analysis
 - Income statement items as a percentage of revenue over time
 - Balance sheet items as a percentage of total assets over time
 - Horizontal analysis
 - Financial information presented as a percentage of a base year's figures
- Ratio analysis on loan customer financial statements
- Comparison of borrower's financial results to industry benchmarks




ADDITIONAL INVESTIGATION EXAMPLES



VAULT CASH EMBEZZLEMENT




- Head teller embezzled \$2M in vault cash over a 17-year period
- Took cash directly out of the vault as dual control access was not required & not all vault cash was physically counted
- Stuffed cloth cash bags with folded empty cash bags to simulate cash, tagged & secured







VAULT CASH EMBEZZLEMENT COMMON THEMES


- Head tellers/managers overly controlling
- Involved even on vacation – may text or email to stay in control
- Lack of persistence by others in surprise counts
- Dual controls over vault cash largely ignored
- Security cameras not working or not covering all relevant areas
- Losses hidden in areas not physically counted



CD LAPPING SCHEME




- 16-year employee
- Age: early 60s
- Worked quietly at a lobby desk in a branch
- Became the “go-to” person for CDs
- Opened more accounts than anyone else
- Trusted & loved by everyone
 - Other branch employees’ children called her “grandma”







CD LAPPING SCHEME

- Started stealing customer funds from CDs
- Told us she couldn't remember a time when she wasn't stealing customer funds
- Average impacted customer age was 70



HOW SHE DID IT

- Customer came in with funds to open a CD
- Walked to the teller line, set up CD for less
- Kept the difference (skimming)
- Went back to her desk, printed a CD showing what the customer thought was just deposited
- Other times, she just withdrew cash under the guise of helping a customer (larceny)



HERE, SHE KEPT \$9,500.00

TIME DEPOSIT TRANSACTION TICKET		DATE
CUST. NAME: _____		08-19-2004
SIGNATURE: _____		
AMOUNT	EFF. DATE	APP. BY: _____
9500.00		
817 38 4051	614560	
08/19/2004	\$6,145.60	

CASH OUT TICKET	
TELLER NO. 011	
950000	
0188871 CASHOUT	99,500.00
FGR12+24PK08-19-04 #	
08/19/2004	\$9,500.00



YEARS PASS & IT GOT HARDER

- Customers eventually withdraw money
- Problem: she had depleted their accounts
- Had to shift funds from new accounts to “cover” depleted accounts (lapping scheme)
- It spiraled out of control & was hard to keep track of
- But, she had a system ...



HUNDREDS OF PIECES OF PAPER IN A TOTE BAG

TDREST (LST) TD REQUEST STATEMENT BANK
 ACCOUNT NUMBER TITLE OR

PREVIOUS STATEMENT BALANCE	.00	DATE LAST STATEMENT 00/00/00
PLUS DEPOSITS AND CREDITS	125,000.00	
LESS WITHDRAWALS AND DEBITS	.00	
CURRENT STATEMENT BALANCE	125,000.00	

EFF DATE	POST DT	IRA TC	AMOUNT	DESCRIPTION	ITEM SEQUENCE NBR
03/06/08	03/06	00 38	125000.00	TIME DEPOSIT	201-200-411-483214


+ 11,500.00 me
 136,500.00
+ 6,342.63 me
 142,842.63 *that should be*

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HOW DID THIS HAPPEN


- Failure on management's part to question multiple cash deposits into her account
- Bank policies allowed numerous penalty-free withdrawals from CDs
- Complete trust – she was in charge of printing & reviewing periodic CD statements & mailing them to customers
- Customer questions regarding their CDs were sent to her

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REMINDER ABOUT LIFESTYLE CLUES


- In approximately 80% of cases, there was a red flag that was missed or was apparent in hindsight
- Most common red flags were
 - Living beyond means 45.8%
 - Financial difficulties 30.0%
 - Too close association with vendor/customer 20.1%
 - Wheeler-dealer attitude 15.3%
 - Unwillingness to share duties 15.3%




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EFFECTIVE AVENUES TO LOWER FRAUD RISK IN FINANCIAL INSTITUTIONS






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SEGREGATION OF DUTIES


- Custody vs. authorization vs. record keeping
- Objective is more than one pair of eyes
- Oversight & monitoring
- A few to focus on (there are many more)
 - EFT – origination, processing, confirmation & record keeping
 - Lending – relationship management, underwriting, processing, disbursement & record keeping
 - Independent reconciliations
 - Dual control over cash & collateral



KNOW RELATIONSHIPS WITH LARGE LOAN CUSTOMERS




- Strict policy regarding conflicts of interest
 - Disclosure
 - Noninvolvement
 - Annual written certification
- Keen awareness & monitoring where conflicts are known to exist
- Be aware of relationships & ask questions where you are unsure
- Push back on things that seem unusual







NO CASH TRANSACTIONS OUTSIDE PRESENCE OF CUSTOMER


- Balance between security & customer service
- Processing of transactions as a “favor” to customer
- Backbone of many fraud schemes
- Stopping this practice can prevent many schemes we have seen over the past five years
 - Lapping in customer accounts
 - Fictitious loans
 - Theft from customer accounts
 - Unauthorized draws on lines of credit



GOOD CONTROLS AROUND ACH & WIRES




- Follow the controls religiously
- Do not make exceptions
- Train employees to protect bank credentials
- If you are not sure your controls are good enough in this area, have an assessment done







SURPRISE CASH COUNTS


- Do them regularly
 - Must be a surprise
 - Must count everything



OFFICER, DIRECTOR & EMPLOYEE ACCOUNT REVIEWS


- Do not put this on the back burner
- Does not have to be 100% coverage
- Must include officers & directors
- Make sure someone qualified is performing the review
- What to look for
 - Unusual levels of cash transactions
 - Nonpayroll deposits
 - Bank journal entry credits
 - Deposit of loan proceeds or cashier's checks






FRAUD AWARENESS TRAINING

- Targeted training for employees & managers
- Cannot effectively fight fraud just through accounting or internal audit department
- Organizationwide awareness is critical
- Lower losses & shorter duration can be correlated to awareness training for employees




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CONFIDENTIAL HOTLINE

- Single most cost effective anti-fraud action
- Tips are number one way that frauds are detected
- Most tips come from employees
- Both a deterrent & a detection method
- Lower losses are observed where a hotline is present
- Puts employees on notice that you want to know
- Must train bank employees not to process unusual transactions & what to do when it happens




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MANDATORY VACATIONS

- Someone must fill in for employees on vacation & perform their duties
- Job rotation can also be used
- Many problems are identified during perpetrator vacations




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USE YOUR DATA

- More data & better tools often allow high-quality searches for unusual patterns
- Associated with a 54% reduction in fraud losses & 50% reduction in fraud duration
- Examples of data sets for banks
 - Loan masterfile
 - Loan maintenance files
 - Vendor & employee masterfiles
 - AP detail & payroll detail files



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EXAMPLE: LOAN MAINTENANCE FILE ANALYSIS

Loan Maintenance Detail						
90+ Delinquent						
Borrower	Loan #	Old Info	New Info	Run Date	Type of Change	Use
255850	27-093	7665		0 11/9/2004	90 + delinquent	JEFF
22120	28-306	1350		0 12/9/2004	90 + delinquent	jeff
27662	28-330	5625		0 12/15/2004	90 + delinquent	jeff
255850	27-093	2555		0 12/27/2004	90 + delinquent	jeff
231404	26-895	720.09		12/31/2004	90 + delinquent	
28060	27-150	826.95		0 3/23/2005	90 + delinquent	karla
22015	26-720	831.59		0 6/23/2005	90 + delinquent	jeff
23325	27-131	15164.92		0 6/23/2005	90 + delinquent	jeff
24004	22-582	8758.16		0 6/23/2005	90 + delinquent	jeff
24253	27-966	1802.77		0 6/23/2005	90 + delinquent	jeff
233027	28-309	101.43		0 6/24/2005	90 + delinquent	jeff

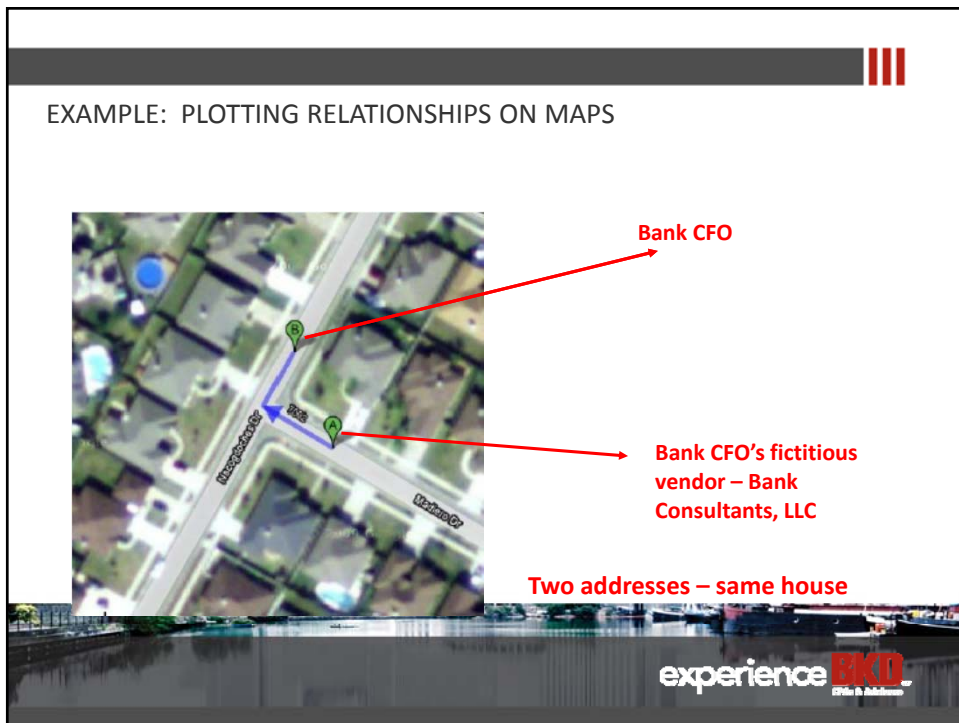
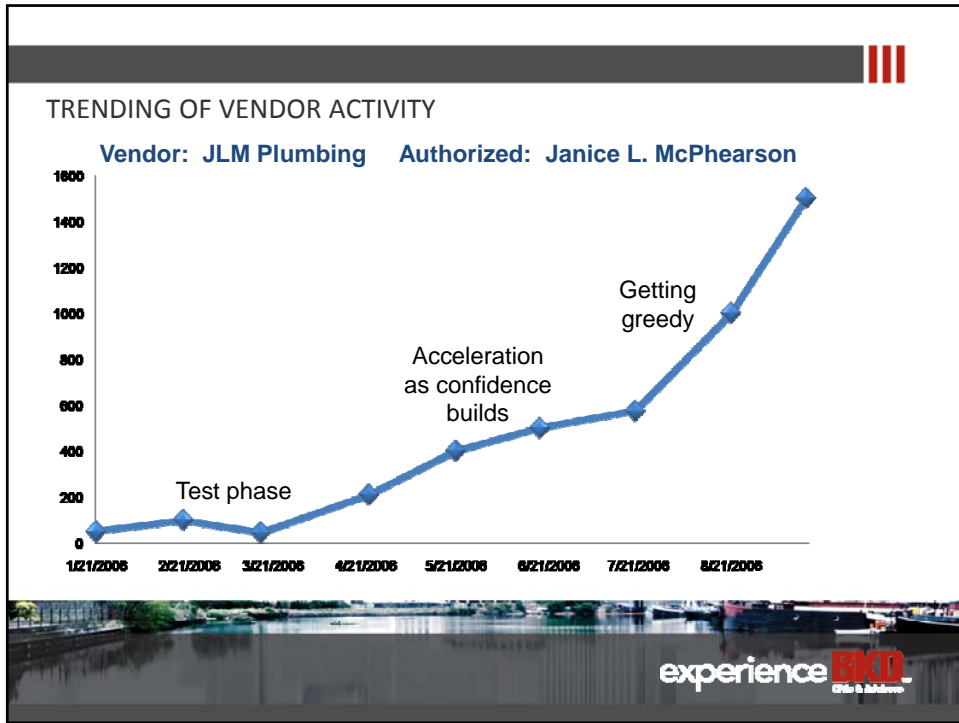


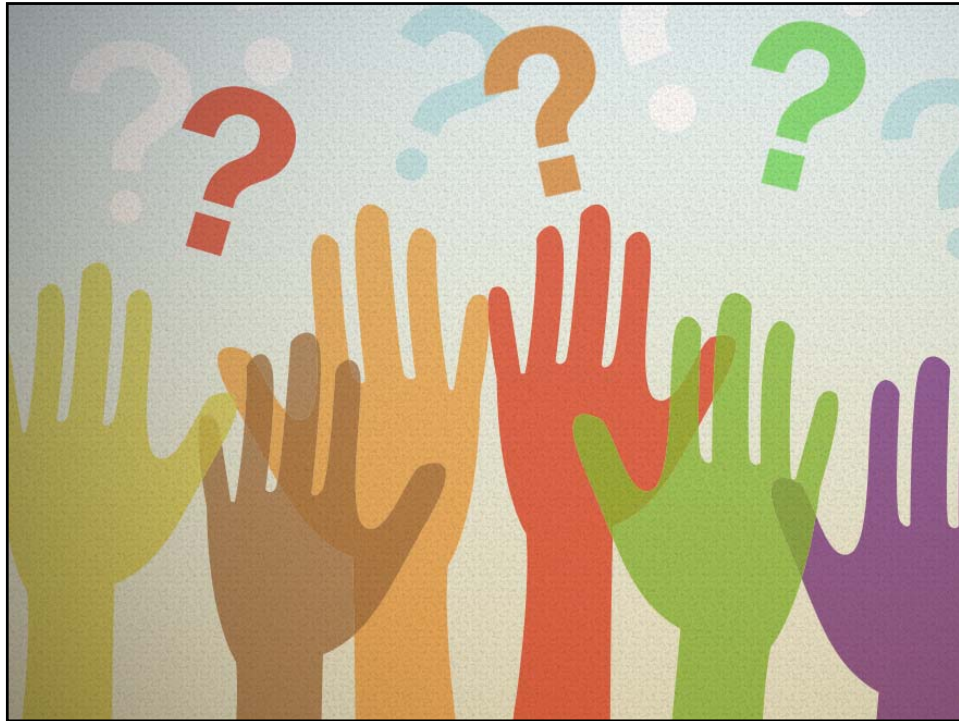
VENDOR ATTRIBUTE ANALYSIS – EMPLOYEE/VENDOR ADDRESS MATCHING

Vendor Information				Employee Information			
Vendor TIN	Vendor Name	City	Total Amount Paid from January 04 to July 2005	Street	Region	NAME	ADDRESS1
227620426	454385 JPS			no activity 605 HIGHLAND AVE SW			605 Highland Ave Sw
241720797	437069 L&L LANDSCAPING		\$ 3,795.00	3139 BECK'S CHURCH RD			3139 Becks Church Rd
243664534	509775 RIDGECREST INVESTMENTS LLC		\$ 187,708.00	315 RIDGECREST DRIVE			315 Ridgcrest Dr.
250085378	434913 KELLY MARKETING			no activity 436 EAST TIERRA DR			436 E. Tierra
255398736	497638 EDGE INTERACTIVE GRAPHICS		\$ 1,748.00	1247 DEE KENNEDY RD			1247 Dean Kennedy Rd
259089739	525761 SIMS JANITORIAL SERVICES		\$ 70.00	1510 LITTLE RIVER DRIVE			1510 LittleRiver Dr
269169762	443969 ALLOGOODS LAWN CARE		\$ 13,042.00	151 MONTGOMERY RD			151 Montgomery Road
265969006	445631 MORRIS PHOTOGRAPHY		\$ 2,472.00	1234 ST. STREET			1234 St. Street
292649087	496812 AJS LAWN CARE SERVICES		\$ 225.00				P. O. Box 141
294847554	473441 DEBBIE ENGEN			no activity 582 CROSSINGS BLVD #216			580 Lake Terrace Drive
319729230	424920 SERVICE PLUS		\$ 920.00	877 LIBERTY STREET			612 California Avenue

Vendor addresses match employee addresses








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