



Watching the Vault: Employee Dishonesty

Managing your most pressing risks

NCOFCU 2016 Conference
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What's in store for today

- CUNA Mutual Group claims statistics
- Statistics from the Association of Certified Fraud Examiners, Inc. (ACFE)
- Case studies



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A continuous challenge



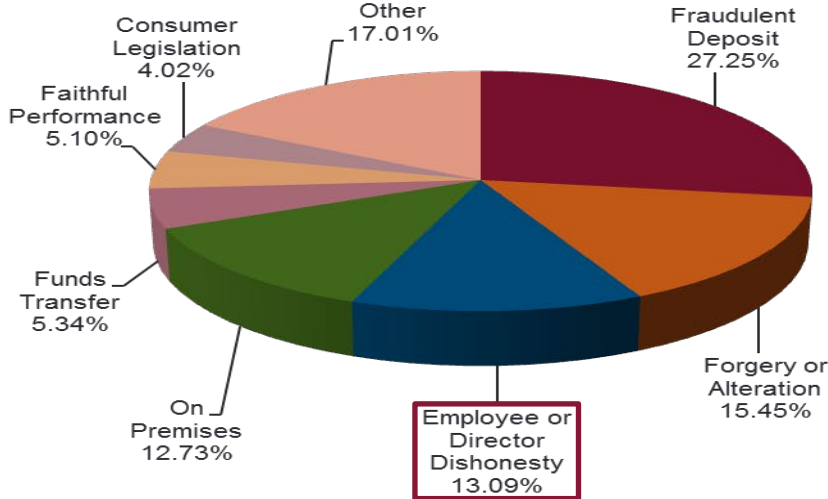
Employee or director dishonesty losses

- Infrequent in nature, but severe monetary losses
- Severity is increasing

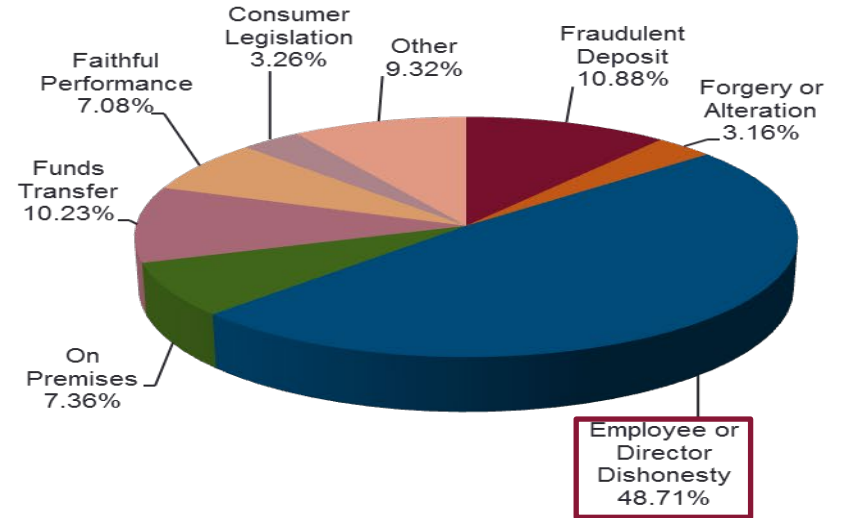
Bond claim trends: Incurred losses

Embezzlement schemes are longer in length resulting in bigger losses

Bond Claim Count
(frequency)



Bond Claim Dollars
(severity)



Source: 2011-2015 CUNA Mutual Group internal claims data

Famous last words

- *It could never happen to us*
- *We trust our employees*
- *All of our employees are long-term*
- *Our controls can't be circumvented*
- *We don't employ thieves*
- *We live in a smaller community and don't see that type of activity*
- *We are a small credit union*

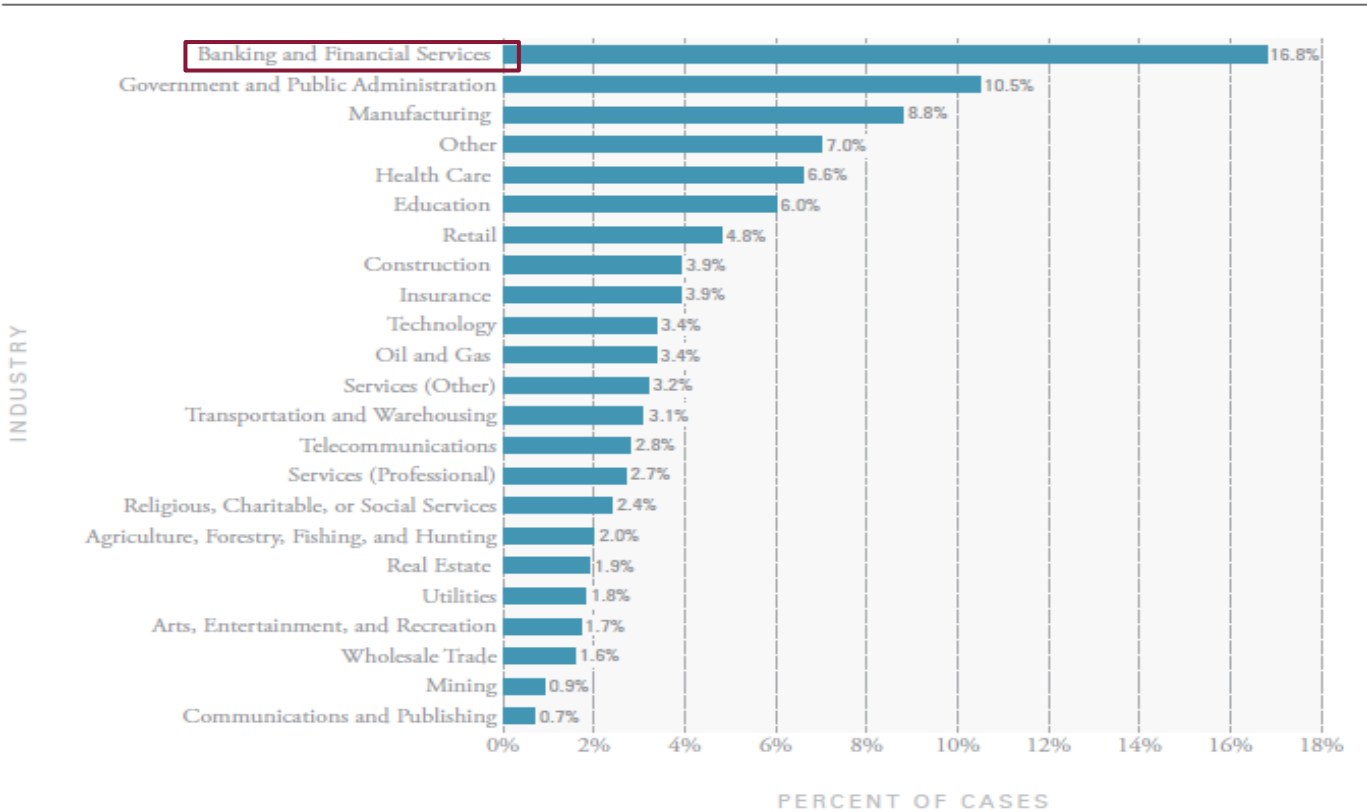


Employee dishonesty claims
are the **#1** claims category
under the Fidelity Bond*

* Underwritten by CUMIS Insurance Society, Inc.

Financial services - top victimized industry

Figure 43: Industry of Victim Organizations

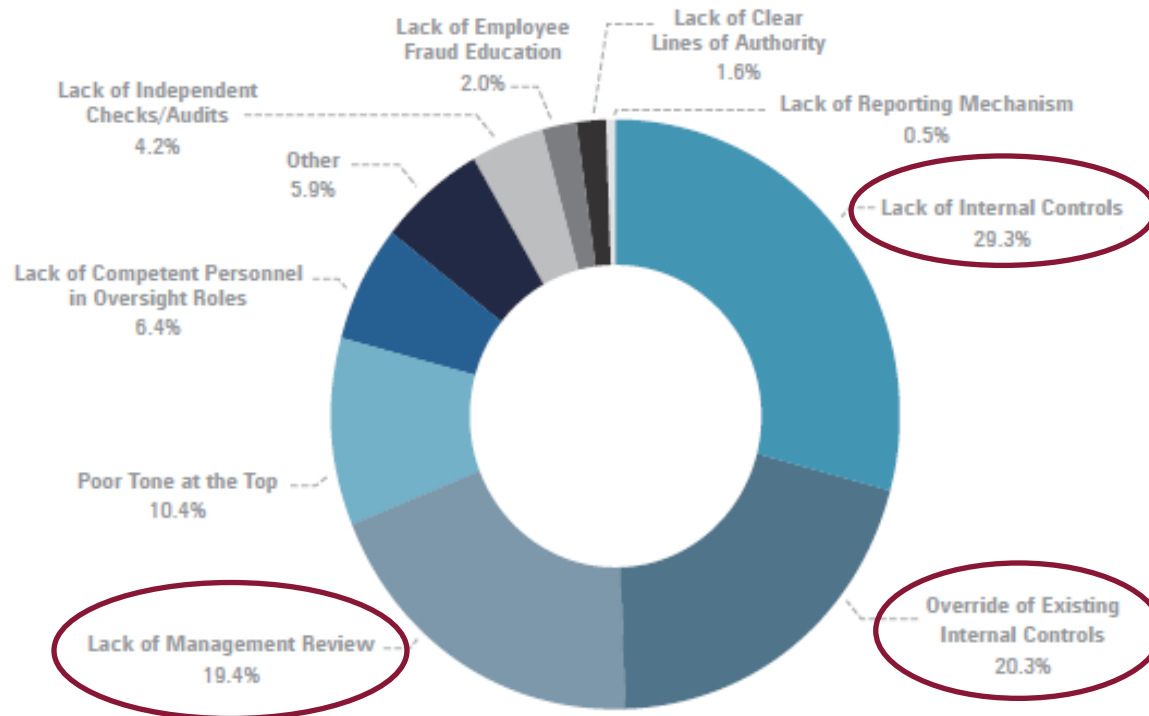


- Highest # of cases (368)
- Highest percentage of cases (16.8%)
- Median loss \$192,000

Source: 2016 Report to the Nation on Occupational Fraud and Abuse, Association of Certified Fraud Examiners, Inc.

Lack of internal controls is the main cause

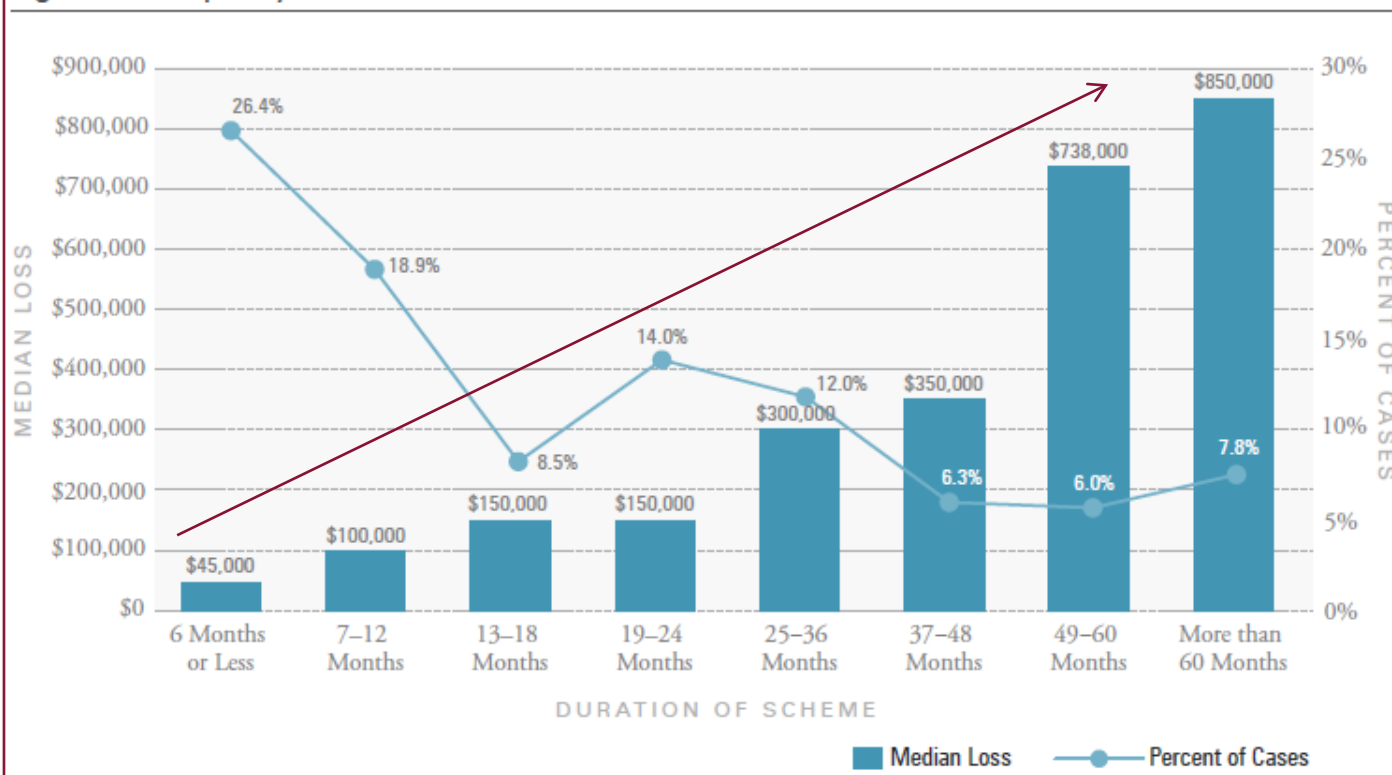
Figure 63: Primary Internal Control Weakness Observed by CFE



Source: 2016 Report to the Nation on Occupational Fraud and Abuse, Association of Certified Fraud Examiners, Inc.

Duration and severity of embezzlement

Figure 18: Frequency and Median Loss Based on Duration of Fraud

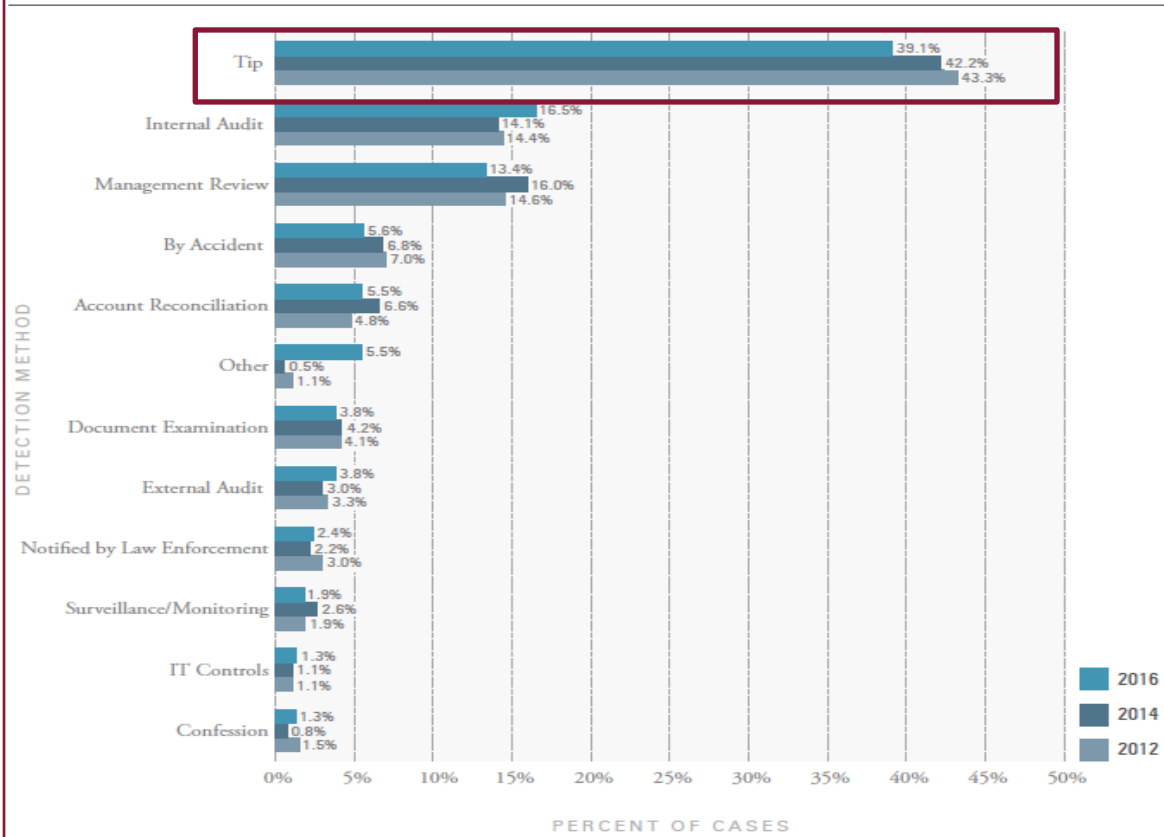


Early detection
is critical

Source: 2016 Report to the Nation on Occupational Fraud and Abuse, Association of Certified Fraud Examiners, Inc.

Fraud hotline helps in the detection process

Figure 21: Initial Detection of Occupational Frauds



- Tips were the most common detection method by a wide margin, accounting for 39.1% of the cases
- Organizations that had fraud reporting hotlines were much more likely to detect fraud through tips than organizations without hotlines – 47.3% compared to 28.2%, respectively

Source: 2016 Report to the Nation on Occupational Fraud and Abuse, Association of Certified Fraud Examiners, Inc.

Recipe for an embezzlement

Traits that create a powerful temptation

- Need (*perceived financial need*)
- Opportunity (*weak or non-existent controls*)
- Rationalization (*“just this once” is a way of life*)



Employee fraud – theft of cash

CASE STUDY

- Vault teller stole \$100,000 from her cash drawer
- Evaded detection during surprise cash counts by making entries to sell cash to other tellers
 - Reversed entries afterwards
- Stole \$20,000 in bait money from vault
 - Bait money was never included in surprise cash counts



Impact

\$120,000 stolen from teller drawer and vault cash over 2 year period

Source: CUMIS Insurance Society, Inc.

Employee fraud – theft of cash

CASE STUDY

- AVP / Vault teller evaded detection during surprise cash counts on vault cash
- Made entries to sell cash to other tellers and moved funds to the ATM general ledger account
 - Reversed entries afterwards



Impact

\$826,000 stolen from vault cash over 10 year period

Source: CUMIS Insurance Society, Inc.

Employee fraud – theft of cash

CASE STUDY

- As manager, she knew when surprise cash counts were scheduled
- Evaded detection by selling cash to a non-existent cash drawer
- She transferred the funds from the non-existent cash drawer to a general ledger suspense account afterwards
- She was responsible for reconciling general ledger accounts



Impact

**\$2 million stolen from vault cash
over 13 year period**

Source: CUMIS Insurance Society, Inc.

Relevant internal controls - cash



- Dual control over vault cash
- Tellers should have exclusive control over their cash supply
- Frequent surprise cash counts
- Block tellers from selling/buying cash to/from each other
- Review transactions initiated by teller or vault teller shortly before start of surprise cash audit
- GL suspense/clearing accounts should be reconciled by someone without GL posting authority

Employee fraud – fictitious loans

CASE STUDY

- VP of lending created 3 fictitious loans
- He opened the fraudulent accounts on the system
- He disbursed the loan proceeds
- He advanced payment due dates on the loans to prevent them from appearing on the delinquency reports



Impact

\$250,000 stolen over 3 year period

Source: CUMIS Insurance Society, Inc.

Employee fraud – unauthorized loans

CASE STUDY

- Loan officer created unauthorized share secured loans on dormant accounts
- He flagged accounts as “do not mail”
- Scheme detected when a member called credit union about not receiving statements



Impact

\$250,000 stolen over 2 year period

Source: CUMIS Insurance Society, Inc.

Relevant internal controls – lending



- Segregation of duties in the loan department
- Periodic loan audits
- Review file maintenance reports
- Protect dormant accounts/audit activity on dormant accounts
- “Do not mail” account controls and audits
- Statements mailed to branch office

Employee fraud – Visa payments

CASE STUDY

- Involved 3 employees at the credit union
- Entered payments on their credit union issued credit cards using the Visa terminal
- Actual payments were never made
- Created out-of-balance situation for Visa Loans Outstanding between general ledger and processor's reports
- One of the employees was responsible for reconciling the processor's monthly report showing Visa loans outstanding



Impact

\$750,000 stolen over 2 year period

Source: CUMIS Insurance Society, Inc.

Relevant internal controls – card services department



- Deploy lockout feature on card terminal/web interface to card processor so that card staff are blocked from posting transactions and making changes to their own accounts and family member accounts
- Audit credit card accounts of card department employees/family members
- Monthly card processor report of credit card loans outstanding should be reconciled to the general ledger by someone outside of card department

Employee fraud – theft of purchased equipment

CASE STUDY



- VP of IT purchased technology equipment (PCs, laptops, mobile devices, etc.) with credit union funds
- He performed all steps in the purchase process
- He took the equipment home and sold it – pocketing the proceeds

Impact

\$2 million loss

Source: CUMIS Insurance Society, Inc.

Relevant internal controls – equipment purchases



- Segregation of duties
 - Purchase requisitions/requests should be approved by a higher level of authority than employee requesting the purchase
 - Employee requesting the purchase should not issue payment
 - Employee requesting the purchase should not accept delivery of the equipment
- Perform periodic inventories of equipment

Discovery of employee dishonest act

Report employee wrongdoing to CUNA Mutual Group's Bondability Underwriting area regardless of any loss.

- The Fidelity Bond, underwritten by CUMIS Insurance Society, Inc. contains a provision stipulating coverage for an employee terminates automatically when the credit union becomes aware of any dishonest or fraudulent acts committed by the employee, or any intentional violations of established and enforced share, deposit, or lending policies by the employee
- Problems arise when a credit union fails to notify CUNA Mutual Group and elects to retain an employee who committed a dishonest or fraudulent act
- If the employee subsequently causes a loss and it is discovered during the investigation that the employee committed a prior act, the claim may be denied

Bondability verification and background checks

Make sure you're hiring the right people

- Screen candidates through CUNA Mutual's Bondability Verification database
- Conduct criminal background checks



Session wrap

- Powerful temptation for some
- It just doesn't happen to others
- Credit unions of all asset sizes are exposed
- Simple controls and audits can be implemented
- Maintaining a good internal control environment will help prevent (but not eliminate) employee fraud





Thank you for the opportunity to partner on managing risk.





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