



Anatomy of Fraud

Beware of the Indicators



Agenda

- Introduction
- Fraud Concepts and Types of Fraud
- Cases
- Bond Insurance Considerations
- Final Questions & Discussions



"The right person, in the right place, at the right time, can steal millions."

Gregory Nunn



***"Fraud will happen.
Expect It."***

Steve Lillie



1

Financial Statement Fraud



Misrepresentation of Financial Statements

WHAT?

- 1 Mask DQ loans
- 2 Defer loan charge-offs
- 3 Increase earnings for year end bonuses
- 4 Increase asset size to make CEO look good (and growth goals)
- 5 Hide incompetency

HOW?

- 1 Bump due dates
- 2 Rewrite bad loans
- 3 Understate ACL account
- 4 Share CD specials
- 5 Plug reconciliations

2

Misappropriation of Assets



Misappropriation of Assets

- “Borrowing” cash
- Fictitious loans and repayments
- Phantom share deposits
- Indirect lending kickbacks
- Loans to family and friends
- Use of unrecorded non-member share deposits (not recorded on the books)



Common Elements of Fraud



Critical Warning Signs

Defensive attitude

Growing DITs on Bank Reconciliation

Bank reconciliations not performed timely

Employee lifestyle beyond means

Controls centered around one person

Key individual takes no time off

Unexplained reconciling items

General Ledger accounts not reconciled

Beware of nepotism



Data Smoke – Change Fund



Data Smoke – Loans



Data Smoke - Other



Case #1

\$46 million in assets

Two employees with the same scheme

Total loss exceeded \$5.5 million

PRESS RELEASE

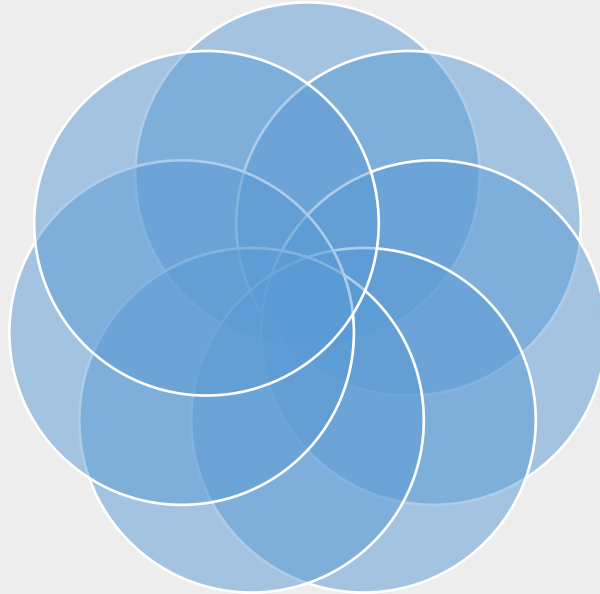
**Former Southern Pine Credit Union President
Sentenced to Prison and Ordered to Pay Nearly \$4.5
Million Restitution**

Case #1 Overview

CEO and Controller worked together to commit this fraud

- The CEO is serving a 6 year prison sentence
- The Controller is serving 5 years in prison

Over 25 individuals (mostly family) received benefit (including the CEO and Controller).



Over a 5-year period, \$110 million of transactions conducted through the CEO and Controller (and family) accounts.

Money stolen was concealed through a series of fictitious loans.

Embezzlement occurred for more than 17 years.

Loan portfolio overstated by \$5.5m but would be adjusted down at each quarter-end for the Call Report.

Credit Union had only 5 employees.

Case #1 Facts

Additional Facts

	Discovered during the pandemic
	Corp. Credit Union contacted Georgia Dept. of Banking and Finance
	The CU settlement account had over drafted by over \$1 million.
	Mgt. claimed liquidity issues related to the COVID crisis.
	NCUA and GDBF could not perform onsite contacts due to travel restrictions.

Similar situations may occur with NCUA down-sizing

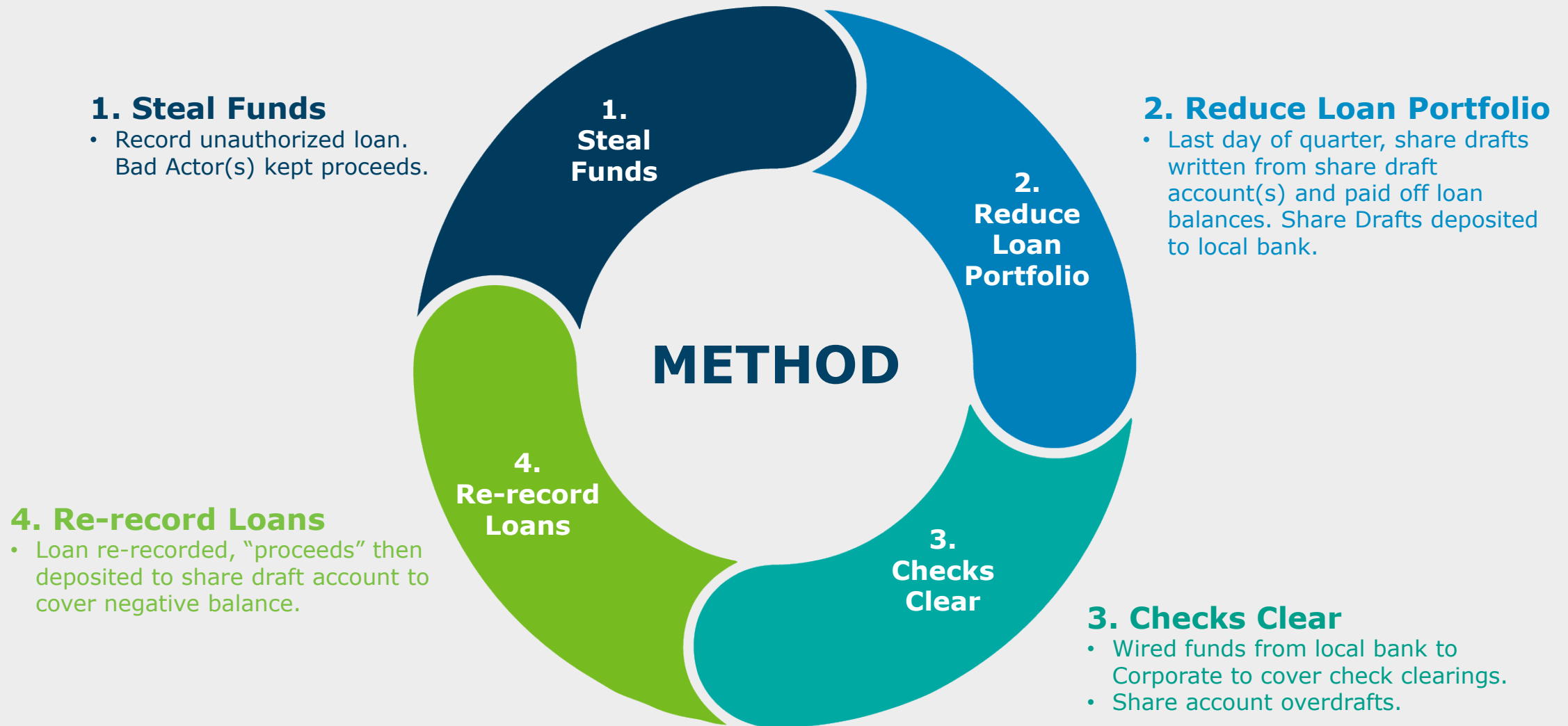
Case #1

Concealment Technique



- At each quarter end, the loan balances would be reduced through payoff of loans using share drafts from the fictitious accounts.
- This kiting would then be covered by advances on the loans to cover the share drafts.
- S/D clearing became too large, it was necessary to wire funds from another bank account to corporate.

Case #1



Case #1

How could this happen??

CEO and Controller had access to and controlled all aspects of the operations

Weak Board oversight of financial results.

No opinion audit.

Thieves were aware of 5300 results and adjusted quarterly

No review over employee account activity



Case #2

CU SYSTEM

Former Taupa Lithuanian CEO pleads guilty to \$15M fraud

February 4, 2014 |



CLEVELAND, Ohio (2/5/14)--Alex Spirikaitis, the former CEO of now-defunct Taupa Lithuanian CU, pleaded guilty to conspiracy to commit bank fraud in U.S. District Court Monday.

- Small Credit Union, \$24m. In N.E. Ohio
- Loss of \$33m to NCUSIF.
- Allowed accounts to overdraft and created fictitious deposits.



CLEVELAND, Ohio -- [Taupa Lithuanian Credit Union](#) in Cleveland was closed Monday by state regulators.

The credit union served 1,154 members and had assets of nearly \$24 million. It was chartered in 1984 and served the Lithuanian community in Greater Cleveland.



Case #2 Overview

- CEO was trusted member of the Lithuanian community.
- In collusion with the accountant.
- Three individuals ultimately sentenced for bank fraud.
- CEO sentenced to 10 years in prison.
- Embezzled \$4.6 million for himself – Guns, ammo and \$1.6 million house.

***Interesting
Fact:***

*He is now out of
prison and is a
“Consultant”.
Visit him on LinkedIn*

Case #2 Facts

Additional Facts

- Initial fraud was to allow a member to overdraft acct. by \$50k “short-term.”
- Later, allowed multiple members and employees to overdraft their accounts.
- Added fictitious deposits into CEO’s personal accounts.
- Corporate One employees identified discrepancies.
- 5-year trend in cash showed rapid increase.
- 90% of “reported” cash was in bank account.

Case #2 Concealment

- Duplicate month end reports and AIRES files manipulated as needed.
- Hid \$18 million in overdraft accounts using modified AIRES file.
- Offset negative share balances against legit share accounts.
- Controlled and manipulated the CPA firm bank confirmations with P.O. Box.
- Created fictitious bank statements with software to overstate the cash general ledger.



Case #2

How could this happen??

Fraudster knew
what kept the
examiners
occupied

No validation
of AIRES files
by auditors or
examiners

Fraudster
controlled
bank
confirmation
process

Creative with
software to
modify
statements

No review over
employee
account
activity

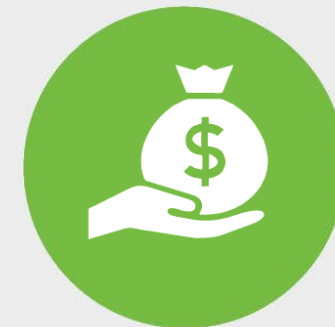


Case #3

\$57 million Credit Union

Losses exceeded \$7 million

Head Teller walked away with cash



The Teller Who Bankrupted a Credit Union

November 05, 2007, 9:05 p.m. EST 1 Min Read



NEW ALBANY, Ind. – Authorities have little hope of recovering any of the \$7 million a teller stole from Obelisk FCU, forcing NCUA to liquidate the 70-year-old credit union earlier this year. That's because the teller, Patricia Sherman, 49, gambled away the funds at riverboat casinos in southern Indiana, authorities said yesterday.

Sherman last week confessed to stealing the money by walking out of work on a weekly basis with stacks of \$100 bills, some containing as much as \$100,000, then cooking the vault report to hide the thefts. She was able to hide the scheme because she helped the supervisory committee conduct an unannounced audit of the cash vault twice a year, enabling her to manipulate the ledger.

Case #3

Additional Facts

- Vault G/L balance grew from \$984k to \$7.8m in five years
- Total cash taken - \$7m in 48 months
- There were regular cash counts by supervisory committee and outside auditors
- GL entries to corporate account were explained away
- CEO/CFO were unaware (ostensibly)
- Concealment: Head teller adjusted G/L vault balance before and after surprise cash counts. Participated in the cash count

Subject pleaded guilty and received 8 years in jail. She had a gambling addiction and is banned for life from all gaming establishments. Claimed she was blackmailed by an armed gunman to steal money.

***Interesting
Fact:***

***Found by a Field
Examiner who
questioned the cash
on hand balance.***

Case #3

Details were in the Data \$7million change fund

STATEMENT OF FINANCIAL CONDITION AS OF DECEMBER 31, 2006
(ROUND CENTS TO THE NEAREST WHOLE DOLLAR. DO NOT REPORT CENTS)

Credit Union Name: OBELISK Federal Charter/Certificate Number: 20173
This page must be completed by all credit unions

ASSETS

CASH:

	Acct Code	Amount
1. Cash on Hand (Coin and Currency).....	730A	\$6,901,572
2. Cash on Deposit (Amounts Deposited in Financial Institutions)	Amount	
a. Cash on Deposit in Corporate Credit Unions.....	\$2,192,202 730B1	
b. Cash on Deposit in Other Financial Institutions.....	\$939,682 730B2	
c. Total Cash on Deposit (Amounts Deposited in Financial Institutions).....	730B	\$3,131,884
3. Cash Equivalents (Investments with <u>Original</u> Maturities of Three Months or Less).....	730C	\$0

Case #3

How could this happen??

Head Teller access
to G/L with no
oversight

Head Teller
controlled all vault
count activities

Incomplete surprise
cash count
procedures

Poor oversight of
financial statements
(CEO and CFO)



Case #4

St. Paul Croatian Federal Credit Union

One of the largest fraud cases in CU history

Credit Union CEO sentenced to 14 years in federal prison.

Ordered to pay \$71.5 million in restitution.

Loss to share insurance fund of over \$170 million



CEO of St. Paul Croatian FCU Sentenced in Massive Fraud.
Anthony Raguz, a former credit union CEO who played a central role in one of the largest fraud cases in U.S. credit union history, was sentenced Monday to 14 years in federal prison and ordered to pay \$71.5 million in restitution by U.S. District Court Judge Christopher A. Boyko in Cleveland.

[CEO of St. Paul Croatian FCU Sentenced in Massive Fraud](http://www.cutimes.com/2012/11/26/ceo-of-st-paul-croatian-fcu-sentenced-in-massive-f)

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Case #4

Identified by SAR Filings

Additional Facts

- Grew from \$52 million to \$250 million in assets in just 8 years.
- \$240 million loan portfolio (\$150 million were share secured loans)
- Zero delinquency and no c/o in 10 yrs.
- Loan concentrations of \$1 mill - \$18 mill
- 1st and 2nd generation Croatians
- Only had 10 employees
- All employees assisted in fraud
- Fraud began in 1998 when one member fell behind on his loan
- CEO received kickbacks of over \$2 mill.
- All available liquidity used to provide “no-repayment” loans to corrupt businesses and individuals

Case #4

How could this happen??

CEO had access to and controlled all aspects of the operations

No Board oversight over financial results.

No opinion audit.

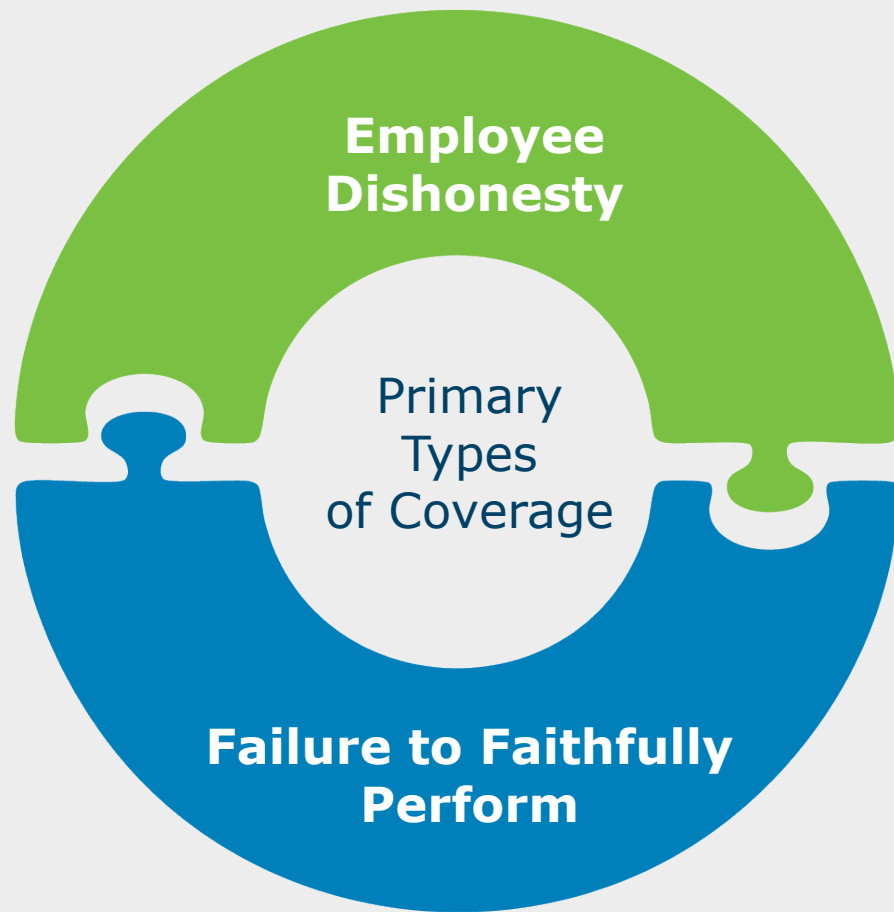
Employees willing to participate due to the Croatian culture.

Examiners were lulled into comfort



This case changed the NCUA bond renewal process

Typical Bond Coverage



Employee Dishonesty

Dishonest acts committed by employee or director, acting alone or in collusion

MUST HAVE

- **Caused a loss**
- **Employee or other obtained an improper financial benefit**



Failure to Faithfully Perform

What it is

Conscious **disregard** of established and **enforced** share and **loan policies**.

What it's not

Negligence, mistakes, acts from inadequate training, **unintentional** violations, **acts of omissions known** to the Board of Directors.



Discovery

First aware of facts – reasonable person's test that a loss could have occurred.

Receipt of notice alleging liability to a third party.

Exact details may not be known. An actual loss may not have occurred.



Notification to Fidelity Bond Insurer

Informal Notification



1-7 Days

Notice of Loss



ASAP but no later than 90 days

Proof of Loss



No later than 180 days

Insurer's Expectations from the CU

Talking with a Bond Attorney first may aid in bond recovery.

- **Take measures to minimize loss**
- **Give insurer reasonable access to records**
- **Notify authorities**
- **Permit interviews of staff & Board**
- **Cooperate**



Analysis – Piecing it Together

- What is initially found is the concealment.
- Identify individual transactions creating the loss.
- Document transaction flow.
- Illustrate embezzled funds were used for personal benefit/gain.
- Provide an understandable narrative of fraudulent event.

What, When, Where, How?



