

# Nuts and Bolts of Internal Security

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DAVID REED, ESQ., CFE



# Your Fraud Flashlight

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David A. Reed

Attorney at Law

Certified Fraud Examiner

david@reedandjolly.com

(703) 675-9578

Reed & Jolly, PLLC

Fairfax, VA

# It's a Hard Topic

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- No one wants to believe their staff members could commit fraud against the Credit Union.
- Many of us look at our shoes or stare blankly into space when internal security is discussed.
- Headlines are filled with stories of Internal Fraud at credit unions!



KBTX News 3

### Former credit union manager admits to embezzling over \$200,000 from elderly client accounts

A 57-year-old Prairie...

Apr 24, 2024



Credit Union Times

### Prison Sentence Given to Former Credit Union CEO for Embezzlement

A federal judge sentenced Kelly Givens to 10 months in prison on Tuesday for embezzling \$10,000 from the \$23.7 million FedStar Federal...

3 weeks ago



KTLA

### Manager of a California credit union sentenced for using bank resources to pay personal bills

A credit union manager in Ventura County has been sentenced to a year in prison after it was discovered she used bank funds to pay her own...

Apr 3, 2024



Roanoke Times

### Ex-CEO of Roanoke Valley credit union gets 10 months in prison for embezzlement

Kelly Givens was responsible for the collapse of the FedStar Federal Credit Union, prosecutors argued.

3 weeks ago



KVUE

### Former employee sentenced for embezzling more than \$300K from Austin-area credit union

Georgetown woman Tracy Mikulencak was sentenced to 41 months in prison for embezzling \$325,708 from a local credit union while she was...

Jan 16, 2024



# Fraud Efforts Are Becoming More Creative

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News

## Former CU Manager Admits Using CU's Fraud-Alert System to Steal From Members

Kelly Jo Muzzana pleads guilty to embezzling more than \$60,000 from Altana FCU members.

By [Peter Strozniak](#) | August 05, 2024 at 03:00 PM

# Scrapbook of Shame

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- Use the mistakes other institutions to improve your process!
- Ask yourself the basic question:
  - How do we do that in our shop?  
or
  - Am I certain we have corrected that issue?
- Real world examples (with real world penalties) may make more impact than your general warnings.
  - A prophet in their own land.....

# Not Just Embezzlement!

## Let's Define Our Terms

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- Internal fraud includes dishonest or illegal activities committed by employees, managers, or executives within an organization. These activities are designed to result in personal gain or to cause a loss to the organization. Internal fraud can take many forms, including theft, embezzlement, corruption, and financial statement fraud.
- Granting or requesting preferential treatment for anyone including consideration that is more favorable to a member, employee, relative, friend, vendor, etc. than the consideration offered by the credit union to any other credit union member.
- It is characterized by the abuse of a position of trust within the organization.

# Key Concept

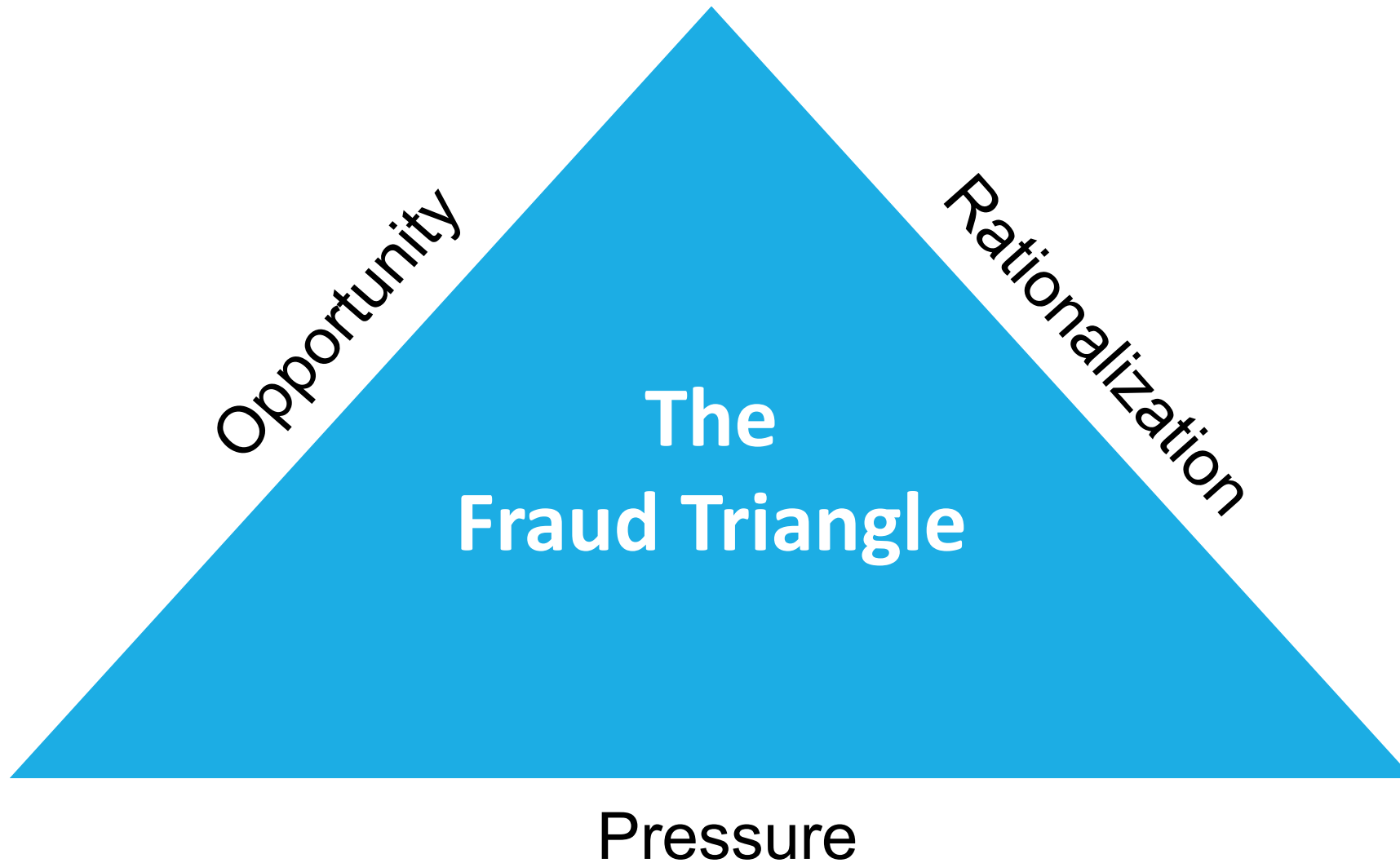
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Much of Internal Security revolves around the concept of keeping an honest employee honest.

In other words, the perceived risk of detection is a great deterrent!



# Donald R. Cressey's Research



# Effective Fraud Prevention

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Leverage existing systems:

- Part 748 Security Requirements
- Patriot Act
- BSA
- FCRA/FACTA (Red Flags)
- Internal Audit
- Operational Best Practices
  - Dual controls
  - Hiring practices/staff reviews

Trust, but verify!!

# What Is an Internal Control?

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# NCUA Rules §715.2 Defines the Term

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Internal control refers to the process, established by the credit union's board of directors, officers and employees, designed to provide reasonable assurance of reliable financial reporting and safeguarding of assets against unauthorized acquisition, use, or disposition.

A credit union's internal control structure consists of five components: control environment; risk assessment; control activities; information and communication; and monitoring.

Reliable financial reporting refers to preparation of Call Reports (NCUA Forms 5300 and 5310) that meet management's financial reporting objectives.

Internal control over safeguarding of assets against unauthorized acquisition, use, or disposition refers to prevention or timely detection of transactions involving such unauthorized access, use, or disposition of assets which could result in a loss that is material to the financial statements.

# A Little Deeper

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Internal control is a process, developed by a credit union's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations.

# Some Background

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- Internal controls include the policies and procedures that financial institutions establish to reduce risks and ensure they meet operating, reporting, and compliance objectives.
- The board must ensure effective internal control programs are established and periodically modified in response to changes in laws, regulations, asset size, organizational complexity, etc.

# Part 748 Requirements

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Part 748 of NCUA's regulations requires a federally insured credit union to develop a written security program designed to:

- Ensure the security and confidentiality of member records and information;
- Protect each credit union office from robberies, burglaries, larcenies and embezzlement;
- Prevent destruction of vital records;
- Assist in the identification of persons who commit or attempt such crimes.

# There's More

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- Part 748.1 Filing of Reports
  - Compliance Report
  - Catastrophic Act
  - Suspicious Activity Report
- Part 748.2 BSA Compliance
  - Establish a compliance program
  - CIP
- Appendix A Member Privacy
- Appendix B Data Breach Notification



# Fraud Protection Starts at Home

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The real key is the oversight at the Credit Union:

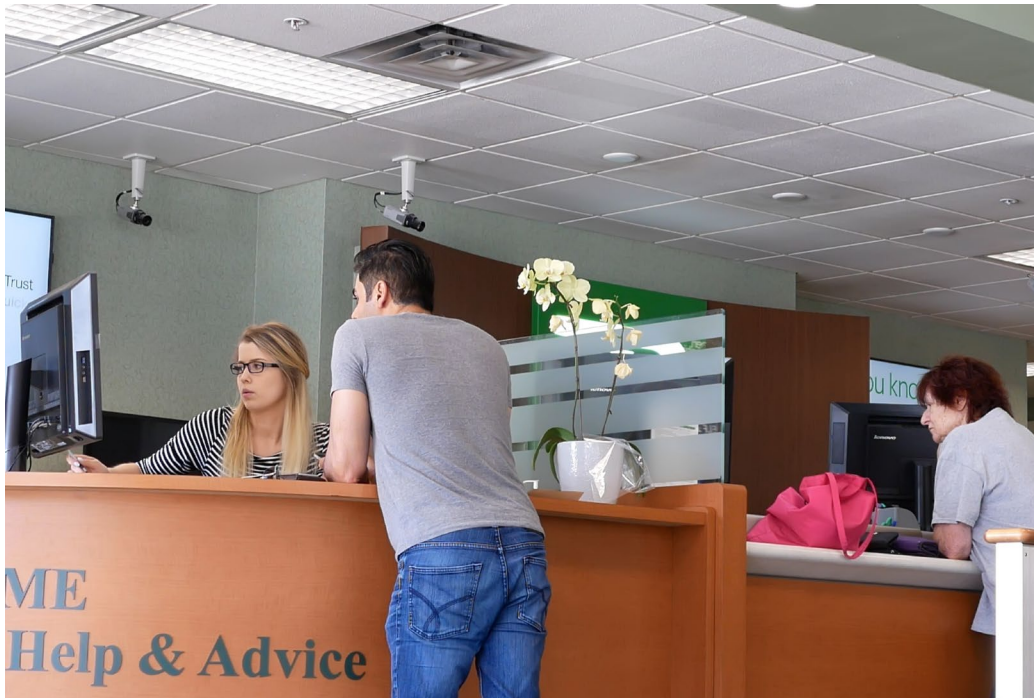
- Management
- Board of Directors
- Supervisory Committee
- Audit

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Everything will be built upon  
your Risk Assessment.

# Who Is the Bigger Risk?

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# Fraud Policy

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- Sets the tone from management
- Employee signature
- Updated annually
- Zero tolerance
- Sample fraud policy
  - Available to TruStage policyholders
  - Located Credit Union Protection Resource Center

# It's the Law!

## §1785 FCU Act

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(1) **In general.**—Except with prior written consent of the Board—

(A) any person who has been convicted of any criminal offense involving dishonesty or a breach of trust, or has agreed to enter into a pretrial diversion or similar program in connection with a prosecution for such offense, may not—

(i) become, or continue as, an institution-affiliated party with respect to any insured credit union; or

(ii) otherwise participate, directly or indirectly, in the conduct of the affairs of any insured credit union; and

(B) any insured credit union may not permit any person referred to in subparagraph (A) to engage in any conduct or continue any relationship prohibited under such subparagraph.

# Security Program

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When developing and implementing a security program, the credit union should:

- Involve the board of directors and SC
- Assess its risk
- Manage and control the risk
- Oversee its service provider arrangements,
- Implement the standards
- Adjust the program as needed
- Train the staff and volunteers

# Employment Practices

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## Pre-Employment Screening

- An ounce of prevention.....
- State law
- Employment Application
- Credit Report
  - Employment Report only
  - Proper Authorization
  - Interpreting the report
  - Adverse Action

# Employment Practices

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## Pre-Employment Screening

- Comprehensive background checks
  - Criminal convictions (Lying, cheating, stealing or violence)
  - Bondability
- Detailed reference checks – 30% of resumes contain serious falsehoods
- Contingent offer



# Balancing Employee Morale & Security

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- Create the proper expectations
- Financial institutions require more security
- No real right to privacy while at work
- Most aspects of internal security will be transparent
- Leverage systems that are already in place within the Credit Union (BSA, Patriot Act, etc.)

# Employment Practices

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## Employee Monitoring

- Ongoing screening program to detect lifestyle changes
- Credit checks, and updated background checks
- Proper authorization

# Employment Practices

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## Employee Monitoring

- Employee reviews
- Whistle Blower or Hot Line Possibilities
  - Must support the whistle blower!
  - How does information get to the SC?

# Employee Discipline

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- State and Federal Law
- Have qualified employment counsel
- Employee Handbook and Policies (Where are your signatures?)
- Progressive Disciplinary Actions
- Consistency

# Insider Fraud Detection

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Experience and common sense are key elements in the identification of potential insider loan fraud. If something does not look right or does not seem to make sense, further analysis is usually needed. In addition, communicating your concerns to the appropriate party early on is critical loss avoidance.

# Audit Function

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- Scope includes compliance with code of ethics, employment practices, loan review systems and internal controls
- Specific audit procedures targeted at insider loan fraud
- Frequent confirmation of loan balances
- Audit includes GL suspense accounts, employee accounts, wire transfers and charged off loans for insider involvement

# Revisit Internal Controls

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- Role of the Supervisory Committee
- Internal fraud risk assessment
- Anti-fraud policies and procedures in place
- Internal control effectiveness assessment

# Recovering Fraud Losses

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- Bond Coverage Issues
  - Annual review
  - Advocacy
- Criminal Prosecution
  - Working with law enforcement
  - Creating your gift-wrapped prosecution packet
- Civil Litigation
  - Always plead fraud in the lawsuit





# Internal Fraud: A Top 10 List

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10. Understand the nature of fraud.
9. Look for ways to leverage existing compliance procedures to assist in fraud detection, control and recovery. Time is your most finite resource.
8. Be creative in showing the value of fraud control to everyday credit union life. Track fraud losses and benchmark fraud control efforts.

# Internal Fraud: A Top 10 List

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7. Understand your product and services conveyor belt. What do you offer your members and how do you advertise them?
6. Know all the doors and windows into and out of your credit union and the risks at each point. How do you deliver each of your products and services? Simple rule: The more remote the delivery or the fewer people involved, the greater the fraud risk.

# Internal Fraud: A Top 10 List

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5. Know your players and how they impact your operations.
4. Don't be afraid to get your hands dirty in order to understand your operations. There may be a difference between policy, procedure and practice.
3. Don't underestimate the power of the dark side! Bad guys and desperate people are smart and adapt quickly.

# Internal Fraud: A Top 10 List

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2. Recognize the role of vendors in compliance and fraud control.
1. Remember who bears the risk of loss in most fraud scenarios. YOU!

Now What?