
CASE STUDY ONE

Judy Blue worked as the Senior Vice President of Lending at a branch of Bank XYZ, which was part of a large bank holding company. The branch enjoyed thriving business after a very slow start.

Judy Blue was originally the President of Bank XYZ, but when business had a slow start she was demoted to Senior Vice President of Lending and her company car was taken away. Judy Blue's loan processor also quit during the slow time and the corporation did not replace her for well over a year. Therefore, the three lenders at the branch of Bank XYZ, including Judy Blue, had to complete and file all paperwork themselves or enlist the help of customer service personnel.

Now Judy Blue also had a sister-in-law who was a local appraiser, and Judy Blue almost exclusively utilized her services. Additionally, Judy Blue had many close ties to people in town due to her family's numerous connections. She often seemed to have indirect relations to many of the individuals to whom she lent money. Judy also had a number of Limited Liability Company (LLC) clients borrowing money from Bank XYZ. However, the LLC's seemed to all be owned by a very small number of individuals.

Judy Blue had a very outgoing, risk-taking personality. One day she was on top of the world as she typed up a cashier's check behind the teller line and handed cash to a teller to make a payment on a client's loan. Another day she was quite introverted and short with employees. Judy Blue rarely took time off from work; and when she did, she would call in to find out who called and what they wanted from her.

She was often questioned on her less than detailed loan files by others at the branch or by corporate management. Judy was pressured to keep her past due loans low and to generate \$x,xxx dollars of new loans in order to receive a large bonus. It was later discovered that Judy Blue made loans to clients multiple times by rolling over principal and allowing either balloon payments or interest only. She created many new loans with several different LLC names. Judy's record was great on both new loan volume and on past due ratios. Although Judy Blue always had poor documentation, management took the view that this was okay because she was selling and did not have time to take care of all the details.

Questions:

1. Based on the case study, identify red flags that could have alerted management to a possible fraud.
2. What internal control weaknesses are evident in the information presented?
3. What measures could be taken to prevent this situation from occurring again in the future?

Answers to Questions:

- Based on the case study, identify red flags that could have alerted management to a possible fraud.
 - Judy had mood changes when she was feeling good about her chances of the deals working but when under pressure she would get short and introverted. **Wheeler Dealer Attitude** and I add Mood changes can be a sign of trying to cover something up.
 - Processor leaving position, management should have interviewed her to find out why she was leaving. In this case it was due to a raise being promised by Judy the lender. When Judy could not get it approved she tried giving the raise by increasing her monthly expenses and then paying her processor out of her expense reimbursement checks. **Intellectual trying to beat the system**
 - Frauds need three components to exist. One is opportunity, two is a need and three is the ability to rationalize why they are deserving of the money they are stealing. In this case there were multiple opportunities due to insufficient controls. There was a need to meet goals, and rationale was that Judy made the bank so much money with her work and they repaid her for her hard work by taking away her title of President and her company vehicle.
 - Judy never was out of touch with office because she did not want anyone to find out what she was covering up. Many banks have a policy where people must take vacations and not have access to their computer or voicemail for at least one week in the hopes of uncovering fraudulent behavior. The FDIC recommends at least two weeks. However, due to staffing issues many banks only make it one week. **Not taking vacations.**
 - Exclusive use of one appraiser or vendor should be a red flag. Most bank's have a list of approved appraisers. **Close relationship with vendor/customer.**

What internal control weaknesses are evident in the information presented?

- Lack of segregation of duties or rotation of duties
- Lack of vacation or shutting off access to computer systems and voice mail. Social engineering of co-workers to get information
- Lack of proper enforcement of policies by upper management (Improper tone at the top)
- Lack of monitoring for conflicts of interest

What measures could be taken to prevent this situation from occurring again in the future?

- Tone at the Top to prevent override of controls.
- Tips from insiders
- Correcting internal control weaknesses noted in #2 above by not looking at cutting corners on staffing and policy enforcement.
- Reassessing bonus structures to incent desired behaviors. Controls around bonus goals to determine games are not played by individuals to achieve goals.
- Creating an approved appraiser list and auditing to determine it is utilized without favoritism or does not involve conflicts of interest.

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