

The Supervisory Committee's Role in Finding Fraud

V304

FIRST EDITION

Written by Lucy Harr
Center for Professional Development
Credit Union National Association, Inc.

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Preface

The **Volunteer Achievement Program (VAP)** is a training program for credit union volunteers. The program is divided into six learning tracks—Board of Directors, Credit Committee, Supervisory Committee, Credit Union Services, Credit Union Technology, and Credit Union Leadership.

There are nine levels of recognition in the program:

1. To be eligible for the basic VAP certificate, you must successfully complete all six modules (core and required) in the learning track you have chosen to pursue. Note that the core modules are recommended, but not required, as part of the Credit Union Technology and Credit Union Leadership learning tracks. You will receive a special certificate for completing the three required modules. (The three modules in the Credit Union Technology track cannot be used as part of the requirements for the other VAP certificates.)
2. To be eligible for the *Edward A. Filene Award*, the second level of recognition, you must complete an additional six modules. These can include the required modules in other tracks or the optional modules.
3. To be eligible for the *Friedrich W. Raiffeisen Award*, the third level of recognition, you must complete 18 modules. These can include the required modules in other tracks or the optional modules.
4. To be eligible for the *Roy F. Bergengren Award*, the fourth level of recognition, you must complete 24 modules.
5. To be eligible for the *Alphonse Desjardins Award*, the fifth level of recognition, you must complete 30 modules.
6. To be eligible for the *Louise Herring Award*, the sixth level of recognition, you must complete 36 modules.
7. To be eligible for the *Dora Maxwell Award*, the seventh level of recognition, you must complete 42 modules.
8. To be eligible for the *Credit Union Technology Award*, you must complete the three technology modules.
9. To be eligible for the *Credit Union Leadership Award*, you must complete the three leadership modules.

The Leadership and Technology series cannot be counted for the overall VAP certificates.

This module is one of the optional modules.

About These Modules

The VAP modules are not intended to provide legal advice, and we do not guarantee the information is appropriate for all state-chartered credit unions. If you have legal or policy questions, contact your credit

union president or your credit union league.

How to Use This Module

If you are sight-impaired and choose to have this module read to you, we suggest that a spouse, friend, or volunteer from your credit union or credit union league assist you. You can also check with your local library regarding reader services available in your community.

If you are participating in a seminar, your instructor will get you started. If you are completing this module through correspondence study, please follow this procedure:

1. Read the module objectives to get an idea of what's ahead.
2. Read the module.
3. When you have read the module and completed the activities, take the competency test.

Competency Test Instructions

Each module in the program has a competency test of 20 multiple choice questions. Only one answer per question is correct. To successfully complete the module, you must correctly answer at least 16 questions. You can refer to

the module as you take the test, but the test must be completed individually.

If you are participating in a seminar, your instructor will provide directions. If you are completing this module through correspondence study, please follow this procedure:

1. Locate the test in the last appendix of the module.
2. Find a quiet place where you can work undisturbed and at your own pace.
3. Record your answers on the scannable answer sheet that was mailed to you along with the module. Follow the instructions on this sheet for marking answers.
4. Complete the identification section on the answer sheet and make sure you have marked an answer for each question. Only one answer is correct.
5. Mail the answer sheet to CUNA in the envelope provided.

You may also take your VAP exam online. Register for online exams at www.training.cuna.org. Click on "eLearning," then on "Self-Study Certificate Programs."

Course Requirements

Certificate Tracks

Certificate Tracks	Track Modules
Basic Certificate & Pin Complete these fundamental courses plus one of learning tracks below	<ul style="list-style-type: none"> History and Philosophy (V01) Financial Reports (V02) Managing Risk (V03)
• Board of Directors	Board of Directors: Duties and Responsibilities (V100) Board Policies (V101) Planning (V102)
• Credit Committee / Lending	Credit Committee: Duties and Responsibilities (V200) Loan Granting (V201) Collections (V202)
• Supervisory Committee	Supervisory Committee: Duties and Responsibilities (V300) Auditing 1 (V301) Auditing 2 (V302)
• Supervisory Committee II	The Supervisory Committee's Role in Due Diligence (V303) The Supervisory Committee's Role in Finding Fraud (V304) The Basics of Risk Assessment for Volunteers (V305)
• Credit Union Services	Introduction to Mortgage Lending (V600) Online Policies and Internet Use (V601) Offering Credit Union Youth Programs (V602)
Technology Certificate & Pin	Credit Union Technology (V500) Planning for Technology (V501) Electronic Fraud and Security (V502)
Credit Union Leadership Certificate & Pin	Strategic Credit Union Leadership (V700) Directing Effective Teams (V701) Maximizing Board Performance (V702)
	<ul style="list-style-type: none"> Marketing (V403) Strategic Planning (V404) Board / CEO Relations (V405) Directors' Liability (V406) Bankruptcy (V407) Financial Management (V409) Credit Union Examinations (V410) Board Reports (V411) Developing, Writing, and Implementing Policies (V412) Marketing to Generations and Target Groups (V413) Recruiting, Orienting, and Retaining Board Members (V414) Asset-Liability Management for Directors (V415) Understanding Regulations (V416) CEO Performance Appraisal and Goal Setting (V417) Business Recovery Plans and Policies (V418) CEO Compensation (V419) Growth Strategies: Pathways to Success (V420) Political Involvement (V421) CEO and Board Succession Planning (V422) Member Business Lending (V423) Investment Essentials for Directors (V424) Budgeting Basics for Directors (V425) Bank Secrecy Act for Directors (V426)

Complete 12 Courses: Edward Filene Certificate and Pin*

Complete 18 Courses: Friedrich Raiffeisen Certificate and Pin*

Complete 24 Courses: Roy F. Bergengren Certificate and Pin*

Complete 30 Courses: Alphonse Desjardins Certificate and Pin*

Complete 36 Courses: Louise Herring Certificate and Pin*

Complete 42 Courses: Dora Maxwell Certificate and Pin*

*Quantity-Based Certificates. Courses can be taken in any order.

The supervisory committee (or audit committee) is often aptly described as the credit union’s “watchdog.” The committee is responsible for ensuring the credit union’s financial records and operations are in order. In a federal credit union, the board of directors appoints the supervisory committee. For state-chartered credit unions, the selection process varies.

The supervisory committee’s role is not a minor role. Your primary role as a supervisory committee member is to protect members’ funds. To do so, you must ensure that you have a sound audit process, and within that, ensure your credit union has effective internal controls.

It’s your responsibility to watch for the things that expose the credit union to loss. The areas of the highest risk should be the highest priority. In so prioritizing, you will need to pay attention to how fraud can cause credit union losses. So although you will not spend all your time seeking out fraud, it does exist and it is part of your job to make sure controls are in place to either prevent it or to stop it in its tracks.

A useful comparison is to think of the governance of the credit union as a system similar to the federal government: the legislative branch, which is our board of directors; the executive branch, which is the CEO and the management team, and the supervisory committee, which is analogous to the judicial branch.

Module Objectives

Upon completion of this course, you will be able to:

1. Identify types of risk associated with credit union operations;
2. Understand the internal controls needed to prevent fraud or expose it quickly to mitigate damage to the credit union;
3. Recognize warning signs that fraud is occurring; and
4. Identify resources available to detect fraud.

Thus, the supervisory committee is part of a three legged governance stool of the credit union. Each of the three legs—board of directors, management, and the supervisory committee—hold an equal amount of the weight and is equally important. When one of the three is missing or weak, the stool doesn’t function.

What You’ll Find in This Course

This course covers the key elements of fraud: the sources, both internal and external to the credit union, and the controls needed to detect, deter, and mitigate fraud.

In chapter 1 we look at who typically commits fraud and examine how internal controls can help your credit union fight back.

In chapter 2 we focus on some of the

common frauds associated with cash and review the tools used to safeguard funds, including surprise cash counts, teller control of funds, dual control of vault funds, keys and combinations, and policy limits on cash amounts. We also review investment frauds and the controls required by NCUA Regulation 703 to prevent them.

Chapter 3 examines the frauds linked to loans and credit cards, and the controls that prevent or mitigate the damage caused by fraud in this area, including member verification, blocking access, review of accounts, exception reports, and change reports, as well as segregation of duties.

Chapter 4 reviews the liability side of the balance sheet—shares and draft accounts as well as dormant accounts—and takes a look at controls, including member verification, negative share balance reports, family account statements, and dormant accounts statements.

In chapter 5, we explore potential fraud in general ledger accounts and review the controls available to prevent or limit damage, including account reconciliation, limiting posting authority, and reviewing balance sheet and expense account activity. We also assess the risk for employee dishonesty with regard to repossessed collateral and look at what can be done to prevent it.

In chapter 6 we broaden our focus to consider external sources of fraud risk and examine what can be done about protecting the credit union from fraud associated with these areas. The Internet represents a high risk and we look at the potential for information technology break-ins and attacks of phishing, phishing, and vishing directed at members. We review examples of forgery and fraudulent deposits and the controls at the credit union's disposal, including new member verification, check holds, and check verification tools.

Plastic cards represent another area of potential fraud and we look at this growing area of concern in chapter 7. We examine examples such as ATM skimming. We conclude by reviewing some of the prevention techniques at the credit union's disposal, including fraud monitoring software, CVV2 or CVC2 codes, effective card activation procedures, and a physical inspection of ATMs.

In chapter 8 we share some advice on how a fraud policy can help mitigate losses, as well as offer tips on detecting fraud and some of the resources available to assist you.

Along the way, we'll provide real-life examples, with names and locations changed, if appropriate, to protect the innocent.