


The Supervisory Committee's Role in Finding Fraud



Credit Union National Association

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Although your primary role as a member of the supervisory committee is not to spend all of your time seeking out fraud, fraud 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.

Objectives

- Establish the role of the supervisory committee in finding fraud;
- Promote awareness of some of the risks your credit union is exposed to;
- Suggest the internal controls you can put in place to either prevent fraud or to expose it quickly; and
- Share some of the resources available for learning more about your supervisory committee duties and preventing fraud.

The Role of the Supervisory Committee

Think of the supervisory committee as part of a three legged stool – a governance stool of the credit union. Each of the three legs – board of directors, management and the supervisory committee – holds an equal amount of the weight and is equally important. When one of the three legs is missing or weak, the stool doesn't function. It's a system similar to the federal government: We have a legislative branch, which is our board of directors; the executive branch, which is the CEO and the management team, and the supervisory committee is analogous to the judicial branch.

The supervisory committee is the “watch dog” and it's your responsibility to watch for the things that expose the credit union to loss. The areas that are of the highest risk should be the highest priority.

The supervisory committee's role is not a minor role. Your role is to make sure that you have a good audit process, and within that, ensure your credit union has good internal controls.



Internal Controls Are Key

NCUA's Regulation 715 – the rules that cover supervisory committees – require you to ensure that internal controls exist and that they are working as planned. Internal controls are a system of checks and balances that help prevent error or fraud or identify error or fraud quickly after it occurs.

Typically, error creates more losses in credit unions than fraud does. Big frauds make the headlines, but overall, frauds tend to be relatively small and identified relatively quickly. Error can result in the biggest write-offs, charge-offs and losses. Examples of errors include errors in recording investment income or a situation where a credit union gets behind in reconciling its corporate account, creating so much confusion and disarray that a large sum of money must be written off.

A good system of internal controls provides the best protection against both error and fraud. That doesn't mean that you, as a member of the supervisory committee, are actually implementing the internal controls. As a supervisory committee member, it is your job to make sure that somebody is doing it and to make sure that it is being done correctly.

Who Commits Fraud?

Unfortunately, fraud is an equal opportunity enterprise. The robber Willy Sutton was once asked why he robbed banks and he replied: "That's where the money is." The same premise applies at your credit union. It seems like everybody can get involved: Staff and management, members of their families, board members, and people external to the credit union such as vendors. With the Internet, virtually anyone can be involved.

Internal Sources of Fraud

The seven areas of concern involving internal operations, listed in order of exposure, include:

1. Cash
2. Investments
3. Loans and Credit Cards
4. Shares and Draft Accounts
5. Dormant Accounts
6. General Ledger Accounts
7. Repossessed Collateral

Cash: Attractive, But Lower Risk of Loss

Cash is an area of relatively low risk, but in risk analysis terms, money has an "inherent attractiveness." Although cash is inherently attractive, the risk of loss is not too great because there are usually many controls in place to track cash. Typically, it's not necessary to spend a lot of time on this area, but it is important for someone to count cash periodically, for one, to show

somebody is paying attention and two, to test that balances do tally with the general ledger.

Controls for the risks associated with cash include:

- Performing periodic surprise cash counts;
- Requiring individual control of funds by the teller, with a spare key under dual control;
- Requiring dual control of vault funds – no one individual should be allowed to access the vault all alone;
- Requiring dual control of keys and combinations;
- Having policy limits on the amount in a cash drawer.

Non-cash Items

Non-cash items are also a source of risk – items such as stamps, travelers' checks, or theme park tickets.

Controls to secure these types of assets include:

- Performing periodic counts;
- Maintaining up-to-date logs; and
- Providing dual-control of all non-cash items.

Other areas to watch are ATMs and the night depository. Dual control and periodic cash counts help control the risk involved when employees load cash into ATMs for withdrawals or handle the deposits from ATMs or a night drop.

Investments: Controls Limit Losses

Controls typically mean investments are a lower risk to the credit union. The outside auditor annually confirms investments as part of the audit. But there are things that can go wrong, for example, a dishonest employee setting up false investments and misdirecting investment funds or part of the interest for personal use or one who is investing with brokers who are providing kickbacks.

Controls for this area include:

- Requiring two people to authorize transactions;
- Periodically confirming investments as part of the annual audit; and
- Setting a selection and review criteria for brokers, as required by Regulation 703.

