


The Supervisory Committee's Role in Finding Fraud



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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