

Spotlight on Internal Controls

Presented by
Aaron C. Mahler
Caroline M. Stapleton
Buckley Sandler LLP



BUCKLEY SANDLER

Why Focus on Internal Controls?



BUCKLEY SANDLER

Examination Priority

- Fraud is a costly problem for credit unions and the NCUSIF
- The NCUA's 2018 exam priorities include a focus on internal controls and fraud
- Examiners expect credit unions will be able to detect and address irregularities



BUCKLEY SANDLER

Enforcement Actions

- Credit unions in the past have been cited for failing to establish internal controls “commensurate with the credit union’s complexity and size”



BUCKLEY SANDLER

What Are Internal Controls?



BUCKLEY SANDLER

What Are Internal Controls?

- Internal controls are designed to ensure:
 - Effectiveness and efficiency of CU operations
 - Reliability of financial reporting, including call reports
 - Compliance with applicable laws and regulations



BUCKLEY SANDLER

What Are Internal Controls?

- Design of internal controls varies depending on a variety of factors:
 - Size
 - Complexity/Sophistication
 - Number of employees
 - Risk profile



BUCKLEY SANDLER

What Are Internal Controls?

“Internal controls do not guarantee that fraud will not occur, but they will make it more difficult for someone to commit fraud and remain undetected.”

- Carolyn Penaluna, NCUA Supervision Analyst, Region IV (June 2016 NCUA Webinar)



BUCKLEY SANDLER

Components of Internal Controls

- Control Environment
- Risk Assessment
- Control Activities
- Accounting & Information Systems
- Self-Assessment/Monitoring



BUCKLEY SANDLER

Control Environment



BUCKLEY SANDLER

Control Environment

- Board/Board committee involvement and direction
- Management philosophy/operating style
- Emphasis on integrity, ethics, and competence, at hiring and going forward
- Board-approved policies/procedures



BUCKLEY SANDLER

Control Environment

- Choosing independent review or audit sets the stage for a strong control environment
- Management style that makes it clear misconduct is not acceptable from Day 1
 - Remember – the credit union is run by *people* who respond to *leadership*



BUCKLEY SANDLER

Risk Assessment



BUCKLEY SANDLER

Risk Assessment

- Risk assessments are designed to identify, measure, and analyze risks
 - Individual business level risks
 - Risks to the entire credit union
- Risks may be internal or external, and controllable or uncontrollable



BUCKLEY SANDLER

Risk Assessment

- Risk assessments are risk *identifiers* that assist separate risk *mitigators* (Control Activities)
- Risk assessments should be conducted regularly to detect emerging issues and re-prioritize risks as needed



BUCKLEY SANDLER

Control Activities



BUCKLEY SANDLER

Control Activities

- Policies, procedures, and practices to control risk at every business level
- Intended to *prevent* and *detect* fraud
- Having procedures is not enough – must conduct regular training and ensure implementation



BUCKLEY SANDLER

Control Activities

- Certain preventative control activities limit opportunities for fraud:
 - Higher level authorizations required for certain transactions
 - Dual signatures requirements
 - Dual custody over access to assets



BUCKLEY SANDLER

Control Activities

- Additional control activities to limit opportunities for fraud:
 - Assign parts of a transaction to different people
 - Limit authorities
 - Safeguard records and assets
 - Evaluate system(s) security
 - Separate and rotate duties



BUCKLEY SANDLER

Control Activities

- Other control activities detect and deter fraud:
 - Surprise reviews (e.g. cash counts)
 - Reports of 0 balance or 0 transaction accounts
 - Perform both regular and unscheduled reviews of key operations



BUCKLEY SANDLER

Control Activities

- Additional control activities to detect and deter fraud:
 - Reports showing fee waivers and low rates
 - Review samples of consumer-facing communications, including phone calls
 - Track and analyze member complaints



BUCKLEY SANDLER

Control Systems



BUCKLEY SANDLER

Control Systems

- Common control systems include:
 - Accounting systems
 - Information management systems
 - Communications systems



BUCKLEY SANDLER

Control Systems

- Systems are important in storing and reporting information
 - Internal controls rely on system reports to inform management and employees responsible for performing monitoring and testing about critical credit union information



BUCKLEY SANDLER

Control Systems

- Systems are important for storing and reporting information
 - Internal controls rely on system reports to conduct adequate testing and monitoring
- Understand your systems' capabilities
- Who is receiving and reviewing reports?



BUCKLEY SANDLER

Self-Assessment and Monitoring



BUCKLEY SANDLER

Self-Assessment and Monitoring

- Internal audit, external audit, and supervisory committees are designed to serve the function of “checking the checker”
 - A comprehensive regular self-assessment can give your credit union a picture of what examiners will find during the examination



BUCKLEY SANDLER

Self-Assessment and Monitoring

- Board-appointed Supervisory Committee is responsible for monitoring internal controls
- Assessments should consider:
 - Internal control objectives and top-down communication of these objectives
 - Sufficiency of policies, procedures, and documentation of internal controls



BUCKLEY SANDLER

Self-Assessment and Monitoring

- Consider evaluating:
 - Personnel understanding of internal controls, through conversations and/or surveys
 - The effectiveness of transaction testing through separate, second-review testing
 - Whether previous findings were promptly corrected



BUCKLEY SANDLER

Hot Topics in Internal Controls

- Third party oversight
- ACH transactions
- Internal controls in small institutions
- Gap analysis



BUCKLEY SANDLER

Questions?



Aaron C. Mahler
Partner
amahler@buckleysandler.com



Caroline M. Stapleton
Associate
cstapleton@buckleysandler.com



BUCKLEY SANDLER