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TO: Kansas Chartered Credit Unions
SUBJECT: Internal Controls

INTERNAL CONTROLS

Employee embezzlement. Employee fraud. No credit union wants or expects it. However, in recent exams, KDCU examiners have found embezzlement and fraud in Kansas credit unions. While the exact reasons behind each crime may never be known, at the end of the day, it is all about greed. According to a 2013 CUNA Mutual Group study, a dishonest employee's actions often are not discovered until over \$130,000 has been stolen over the course of 18 or more months.

Credit union boards of directors have a fiduciary duty to safeguard assets and provide accurate financial data through the 5300 Call Reports. This oversight may not stop employee fraud, but it may allow for the activity to be uncovered more quickly.

What are the contributing factors? Lack of internal controls and management review, override of internal controls and poor leadership.

When a credit union only has one or two employees, it makes the process more challenging, but credit unions must implement segregation of duties and dual controls. Ensure that one person has the key to the vault and another the combination. With one employee, have a third party reconcile the accounts. Do not allow cash drawers to be shared, do not allow employees to transact on their own or family member accounts, review file maintenance reports and conduct surprise cash audits.

Do not allow passwords to be shared. If this happens, then it becomes difficult to determine who committed the fraudulent act. While important in all credit unions, regardless of size, it is vitally important that the Supervisory Committee play an active role in internal control oversight in small credit unions. Employee training is also important.

Internal controls are also important in the loan process. Do not let the same employee handle all aspects of a loan application from beginning to payout. If small, utilize a credit committee.

The following activities can be red flags for internal fraud:

- Living above one's means
- Personal or family problems
- Financial difficulties
- Feeling of being underpaid or underappreciated
- Obsessed with report perfection and timely filing
- Not taking vacations and not cross-training other employees.

For additional guidance, KDCU provides a [Supervisory Committee Checklist](#) on its website.