Audit Control Procedures
Preventative, Detective, and Corrective Procedures

This white paper is part of the Risk Management White Paper Series, which CUNA Mutual Group provides exclusively to its Bond policyholders.
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Introduction to Audit Control Procedures

Credit union operations should be periodically reviewed by people who are independent of these operations.

There are three types of control: preventive, detective, and corrective. Internal controls are part of the preventive control. They are designed to foresee and avert problems. Audit control procedures are part of the detective control. They are designed to see if the preventive controls are working. Revising policies and procedures when a weakness is discovered is part of the corrective control. They are designed to strengthen the internal control process.

The purpose of these audit control procedures is to supplement, not replace, the yearly supervisory audit required by credit union regulators.

Cash Counts

Cash counts are an important part of internal control procedures. Periodic cash counts encourage honesty and discourage embezzlement. Cash counts should be conducted on a surprise basis by someone independent of the cash operation (management, internal audit, supervisory committee, etc).

All cash items, including travelers’ checks, movie tickets, etc., should be part of the cash count. You do not have to count every teller drawer and the change fund all at once. Instead, you may wish to count the change fund one day, the travelers’ checks another day, and several teller funds another day. ATMs and cash dispensers should also be included. The cash counts should be frequent enough to deter dishonesty, or detect dishonesty if it is occurring.

Conduct the cash count in the presence of the employee responsible for maintaining the funds. If there is a shortage, the individual responsible cannot accuse the person performing the cash count of removing funds. In the event that employee responsible for the funds is absent, the key or combination to the container should be retrieved and the cash should be counted under dual control.

Verify cash count totals with the general ledger accounts to determine accuracy.
The key points to remember about cash counts are:

- Cash counts should be a surprise
- Cash counts should be conducted frequently
- The individual responsible should be present
- Cash totals should be verified

**Loans**

Loans are the credit union's largest asset, meaning several areas need to be monitored.

Fictitious/unauthorized loans are a common technique used by the embezzler. Select a sample of loans approved by each loan officer and the credit committee for review. The selection process should include cash payment loans, not loans on payroll deduction. Make sure all the necessary documents are completed. Contact the borrower by telephone to confirm he/she is a real person and the loan proceeds were received. This verification can be done as a customer service inquiry. Refer to "Credit Union Audit Procedure: Detection of Fictitious/Unauthorized Loans" (0281-205) for additional information on conducting this procedure.

Another area to review is the member account trial balance. Review loans with the following indicators to determine their validity:

- Paid ahead due date of more than three months
- High amount of interest due, but the loan is current
- Original loan amount and current loan amount are the same, but the loan is not listed on the delinquency report

A copy of the member's history along with the loan documents can pinpoint any account manipulation. Direct telephone contact with the member may be required.

Employee and family member loans are an easy way for a dishonest employee to obtain funds. Analyze all employee and family member accounts. This review can be done with the overdrawn account review.
The account review should confirm the following:

- Employees are not performing transactions on their own or family member accounts
- Interest rates are correct
- Loan payments are made in the proper amount and at the required frequency
- Collateral requirements are met and the proper documentation is available
- Loan approval is not exceeded as stated by loan policy

Official and family member loans can be used as a means to receive preferential treatment. Officials, by nature of their position, can put undue pressure on credit union personnel to circumvent the loan policy for their own needs. Review these loans to ensure board-approved policies are followed.

Delinquent/charged-off loans should be verified to assure proper collection procedures are being followed. Look at the loan files for indicators of fictitious loans. If collateral exists, has it been repossessed and sold? If a co-maker is involved, has he/she been contacted to begin payments? Are delinquent/charged-off loans reported to the board of directors and recorded in the board minutes? Is all collection activity documented? Are progressive collection efforts being followed?

Co-maker forgery is a potential source of loss for the credit union. Authorized credit union personnel should witness co-maker signatures. If the co-maker is unable to come to the office to sign the documents, a notary public should witness the signature.

The file maintenance report shows any data changes made in the computer system. Data changes can be used to manipulate loan accounts.

Review this report to include the following types of transactions:

- Advancing payment due dates
- Changing interest rates on any account
- Changing the payment amount
- Several address changes to the same address
- Changing the payment frequency
- Changing the collateral code
The key points to remember regarding loan reviews are:

- Contact members to confirm loans
- Prohibit employees from performing transactions on their own or family member accounts
- No one should receive preferential treatment
- Verify delinquent/charged off loans for policy compliance
- Credit union personnel or a notary public should witness co-maker signatures
- Review file maintenance reports on a regular basis to ensure loan manipulation is not occurring

**Overdrawn Accounts**

An overdrawn account is the use of credit union funds without paying interest, or an interest-free loan.

Employee, official, and family member account histories/transactions should be reviewed. Determine if an overdrawn status exists either in the share or share draft account. Review the daily share draft exception report for a 30 day period. Are any employees, officials, or family members listed on the report? Are the share drafts being paid?

Members should not be permitted to overdraw their accounts. The credit union should have an overdrawn account policy in writing. The policy should include a method for dealing with abusers. A review of a computer generated overdrawn share and share draft accounts report will show accounts with a negative balance. Some computer systems will not allow an account to have a negative balance. The overdrawn share drafts are put in a general ledger share draft suspense account. Review the subsidiary account for this suspense account to determine if overdrawn share drafts are being paid or if items are allowed to remain in this account. If the share drafts are not being paid or returned, you must find out why. Members who are allowed to remain in an overdraft status might be kiting. This could lead to a loss for the credit union.

The key points to remember about reviewing overdrawn accounts are:

- Write and enforce an overdraft policy
- Review insider transactions for overdrawn accounts
• Review the daily share draft exception report for a 30 day period to identify abusers
• Review the subsidiary account for the share draft suspense account to determine if items are being paid or returned

**Employee and Family Member Account Review**

Periodically, a review of employee and family member accounts should be done to test for policy compliance. Employees should not be performing transactions on their own or family member accounts. Review unusual transactions, large deposits and frequency of deposits made to cover items being presented for payment. If the data processor provides you with a report of failed log on attempts, this report should be reviewed on a regular basis.

**Dormant Accounts**

Dormant accounts are frequently used to perform unauthorized transactions. Establish procedures to verify transactions. If a dormant account activity report is not available, contact the data processor to find out if the system can generate one. Review this report and consider requiring a supervisory override to conduct a transaction on a dormant account. A verification of withdrawals from dormant accounts should be made. The canceled share draft compared with the member's signature card is one form of verification. Direct contact with the member is another form of verification.

**Closed Accounts**

Closed accounts should also be used by the embezzler. Review the closed account report on a regular basis. Choose a selected sample of closed accounts and compare the canceled share draft/check endorsement with the signature on the membership card to protect against forgery.

**Audio Response/Home Banking**

Cross account transfers (those going from one member's account to another member's account) should be audited periodically to test for legitimacy. Cross-
account transfers should require the signatures of both account holders and only a limited number of employees should have the ability to set up these accounts.

**Bank Reconciliations**

The bank reconciliation of the credit union's checking account can be used to conceal a shortage. Review the bank reconciliations to ensure deposits in transit are posted on the next month's bank statement in a timely manner. Are all additions and subtractions to the reconciliation being resolved in a reasonable amount of time? Returned items appearing on the bank statement might be a sign of kiting. Trace these items to determine if they are being immediately re-deposited or deducted from the member's account.

In summary, if a discrepancy exists, inform the board of directors and management immediately. If the exception involves a manager or board member, notify the next highest level of authority. The credit union's supervisory agency and bonding company should also be put on notice of a potential bond claim.

Evaluate the weakness in the internal control process which allowed the discrepancy to occur. Take corrective action to make sure it cannot happen again.

**Fedline Parameters**

Periodically request the end user authorization contact (EUAC) to print out the Fedline parameters to verify they are properly set. This should be done as soon as it is requested while in the presence of the person requesting the parameters.

**Contact CUNA Mutual Group**

For additional assistance, contact the Credit Union Protection Response Center at 1.800.637.2676. You can also e-mail us at cuprotection@cunamutual.com or visit the Protection Resource Center at www.cunamutual.com/prc.
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