

Maintaining Good Internal Controls During Bad Economic Times



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The current economic environment is clearly taking its toll on organizations, forcing many to cut back, downsize, and restructure their operations. Consequently, many businesses are operating with leaner budgets and are making due with fewer resources. Credit unions, of course, are no exception. However, as budgets are reduced, care must be taken to ensure the control environment remains intact. To meet this challenge during these times of belt-tightening, consider giving your credit union this quick four-step review:

1. Review Specific Controls Related to the Current Uncertainty

The current economic climate is changing credit unions risk profiles. For example, financial uncertainties surrounding asset valuation can result in adverse capitalization, liquidity constraints, increased regulatory scrutiny, and cost cutting measures. Operational uncertainties due to a loss of cash flow can result in staffing reductions, deferred spending on technology and infrastructure, delayed training, and reduced compliance resources. Because budget cuts can impair your control environment and your ability to achieve some business objectives, extra care is needed to maintain adequate control coverage. In addition to reviewing financial controls (those dealing with safeguarding assets and resources) and operational controls (those dealing with internal processes and systems), pay particular attention to credit controls (a borrower's ability to honor a contractual obligation) involving your members, suppliers, and vendors. The focus should be on risks that can destroy member value or hinder your credit union from building value.

2. Review Fraud Controls

Tough economic times are sparking an increase in workplace fraud and it is expected to worsen as layoffs leave holes in organizations' internal control systems according to an Association of Certified Fraud Examiners' report, *Occupational Fraud: A Study of the Impact of an Economic Recession* (www.acfe.com). More than half of certified fraud examiners surveyed reported an increase in the number of fraud cases and the dollar amount lost to fraud during the past year. The type of fraud that increased included embezzlement, identity theft, con schemes, and

securities fraud. Especially now, organizations must be vigilant by ensuring proper internal controls are in place. Be alert to red flags. A single red flag, explored more fully, can lead to the discovery of much bigger issues. Be aware of the elements of fraud or what those in our profession call the fraud triangle: pressure, opportunity, and rationalization. Pressure usually comes from financial needs, opportunities can be created by layoffs and weak internal controls, and rationalization justifying fraudulent behavior as acceptable and normal (theft is considered borrowing or an entitlement due to mistreatment of job dissatisfaction). The tone at the top is very important and it enables a positive control environment. If the senior management team incorporates a culture of ethics by implementing strong internal controls, your credit union can remove much of the opportunity for fraud to occur and can increase the chances of detecting it.

3. Review Business Operations

Distinguish between "must haves" and "nice-to-haves" in order to cut costs. In a sense, the recession is just accelerating changes that need to happen anyway. It is forcing us all to take a hard look at what we are doing and determine how we can work smarter, better, and quicker. Many processes have evolved over time without scrutiny. Perhaps there are opportunities to streamline how your business is conducted by performing end-to-end examinations of processes. Inefficiencies in execution often result from too much or too little documentation, and too little use of technology.

4. Review Existing Competencies

This may be a good time to review your credit union's skill complements to ensure core competencies are aligned with environmental opportunities. If there are skills gaps, look for short-term, creative ways to fill those gaps through mutual partnerships. Foundational to a good controls environment are skilled and knowledgeable employees.

The current economic environment and its onslaught of issues are causing belt tightening and reallocation of resources. Credit unions can best respond to these conditions by reviewing: specific controls related to the current uncertainty, fraud controls, business operations, and existing competencies. The need for a robust system of internal controls is greater now than ever.