



The Auditor's Report

Nearman, Maynard, Vallez, CPAs Celebrates 40 Years of Serving Credit Unions!

Forty years ago, Steve Nearman started the firm with just a handful of clients and a new concept. The firm was created with the idea of building a new type of practice, one focused to only serve credit unions. Since then we have enjoyed serving the credit union community, a community that exists only to serve their members with a focus of people helping people.

Nearman, Maynard, Vallez, CPAs now serves over 170 credit union and credit union service organizations in 28 states throughout the United States and is ranked 3rd in the national market share ranking of CPA firms, by Callahan and Associates, for credit unions with total assets over \$40 million. For the last 40 years, our firm has not been involved in any mergers with any other CPA firms and/or entities; our growth was built on the quality of our audits, excellent client service, and the overall value we provide. We still limit our audit services exclusively to credit unions and by doing so we have an in-depth knowledge of the industry's unique needs and how to serve those needs. As credit unions evolve and the environment they operate in changes, so do our services.

Being auditors, you might think our only goal is to ensure the financial statements we certify are materially correct. Since 1979, our mission has been to provide quality, efficient, and professional services to the credit union industry. We offer our clients more than just audit services. We also serve as a resource and provide accounting expertise, operational knowledge, and compliance services. We have performed pro bono work for community development credit unions, produced a periodic credit union newsletter, put out technical guides, and spoke before various organizations such as the AICPA, ACUIA, NAFCU, CUNA; as well as local credit union chapters and leagues. Our dedication to service is what separates us from other firms.

As we celebrate our 40th year of partnering with credit unions, we want to thank all of our clients and others within the credit union industry for their continued support. We look forward to the opportunities that lie ahead in helping our clients accomplish their goals as we continue to strive to provide complete, quality, and professional services to the credit union industry.

Partners and Associates of Nearman, Maynard, Vallez, CPAs



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Customer/Member Due Diligence (CDD) & Beneficial Ownership

Previously, credit unions and other covered financial institutions were not required to identify individuals who may own or control the legal entity (business membership) if not an authorized signer. This weakness in these requirements and controls enabled owners a tactic to conceal suspicious funds and/or unlawful transactions. Beneficial owners were not identified if they were not authorized signers for the account. The new beneficial ownership requirements address this weakness and require documented information that may better support law enforcement, improve risk assessment, and advance compliance which will assist in safeguarding the financial systems against unlawful use.

Based on FinCEN information, there are four core elements of member/customer due diligence and these should be clearly defined in the BSA/AML program of a credit union. These core elements are:

- 1) Member identification and verification,
- 2) Beneficial ownership identification and verification,
- 3) Understand the nature and purpose of member relationships and develop a risk profile, and
- 4) Monitor relationships for suspicious transactions and current member information.



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Member identification and verification have continually been included in requirements as have understanding the member relationship and risk profile and maintaining current member information. The addition to the core elements is identification and verification of beneficial owners which is similar to the requirements for individual memberships but may impose additional procedures for compliance. Credit unions may easily comply with the beneficial ownership requirements either by obtaining the mandatory ownership information on a standard certification form or by any other process that complies with the requirements to acquire and document the information. The credit union may rely on the information supplied by the member, provided the credit union has no knowledge that may contradict the information provided. There are several avenues available to verify ownership information such as Secretary of State records. Information of beneficial ownership should also be used for OFAC compliance and CTR compliance. Source documents and documented beneficial ownership identification are also required to be retained for five years after the membership is closed.

Customer (member) due diligence includes conducting continuous account/membership monitoring to identify and report suspicious activities/transactions. It also includes maintaining current member information through event-driven and routine monitoring. Risk-based procedures to insure proper due diligence should include understanding the purpose of the member (individual and business) relationship and establishing a risk-profile for the relationship. The risk-profile for the relationship will dictate the level of due diligence necessary to adequately monitor the account activities and transactions. Developing the risk profile includes identifying expected account activities upon account opening and then comparing the activity to actual transactions. The comparison and monitoring can be conducted efficiently using an automated system or a series of system reports based on set parameters. Credit unions which know and understand their members and transactions – individual and business - is a crucial facet of reducing all forms of unlawful financial activities and safeguarding the financial system.

Understanding of the new requirements relating to beneficial ownership and customer/member due diligence along with maintaining updated credit union's Bank Secrecy Act program policies and procedures are essential to maintaining a compliant effective BSA/AML program.

*Tammy Fletcher, NCCO, Internal Audit Manager
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Fraud Fighting Reports For Loans

In today's constantly changing environment, frauds, embezzlements, and dishonestly affect virtually every credit union. Because of the sophistication and ingenuity of individuals fraud, embezzlements, and defalcations are on the rise. This article outlines specialized reports which a credit union may want to consider in the area of the allowance for loan losses account and the loan portfolio. Reviewing these reports are an important tool that a credit union can use to evaluate the lending area from the stand point of the allowance for loan losses account, loans and the lending area.

One of the most critical areas of exposure in a credit union today, which usually results in high dollar losses to a credit union, is manipulation of a credit union's lending area. A regular review of specialized reports is an important part of a credit union's internal control program. Reviewing specific reports can also serve as a fraud prevention tool in that employees may be deterred from fraudulent activity if they know these areas are reviewed on a regular basis.

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Suggested specialized reports listed below are examples of reports a credit union may want to consider as part of their review process. However, it should be noted these reports are a good first step and additional reports may be needed as part of a credit union's review of the lending portfolio. In addition, a credit union may want to add and/or modify the data in the reports in order to meet any of a credit union's specific requirements. Remember the lending area is constantly changing and with new accounting and regulatory changes, these reports need to be evaluated on an on-going basis to ensure they meet a credit union's needs.

Below are several suggested reports covering the allowance for loan losses account that a credit union may want to consider in their analysis and evaluation of the account:

- **Charge-off Loans By Dealerships** - This report can be a useful tool in monitoring charge-offs by each dealership. Unusual trends in the number of charge-offs by dealerships should be evaluated to determine if charge-offs are unusually higher when compared to other dealerships and a credit union's own internal auto loan portfolio.
- **Charge-off Loans By Loan Officers** - This report can be a useful tool in analyzing trends in charged-offs by loan officer. This data may help a credit union in early detection of any potential problems with a particular loan officer.
- **Charge-offs By Grades Of Paper** - This report breaks out the portfolio by charge-offs within each grades of paper which can help a credit union in the evaluation of concentration and credit risk.
- **Charge-offs Per The Board of Directors Minutes To The General Ledger** - A review of the comparison of charged-off loans approved by the Board of Directors to those in the general ledger should be performed on a monthly basis to ensure only charge-off loans which were approved by the Board of Directors were charged off through the general ledger. Inaccurate charge off information will have a direct impact on a credit union's allowance for loan losses experience rates which are used in part for a credit union's estimate of the allowance for loan losses balance.
- **Risk Based Lending Closing Ratio** - The risk based loans closing ratio report provides information on the number of applications, approvals, average beacon score and number of closed loans. In addition, this information can be segregated by grades of paper. This report will also assist a credit union in evaluation of concentration and credit risk.

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- **First Payment Defaults By Dealerships And Loan Officers** - These reports can be a useful tool in analyzing any potential negative trends on first payment defaults by both dealerships and loan officers.
- **Payment Defaults By Age** - These reports can be a useful tool in analyzing any potential trends on payment defaults by the age of member. Care should be taken with this report to avoid any discrimination of the membership based on the member's age.
- **Delinquencies By Loan Officers** – This report can be a useful tool in analyzing the delinquencies by loan officers and assist with early detection of a problem with a loan officer.
- **Delinquencies By Dealerships** – This report can be a useful tool in analyzing the delinquencies by dealerships and assist with early detection of a problem with a particular dealership.
- **Repossessions By Loan Officers And Dealerships** – This report can be a useful tool in analyzing the type and number of repossessions by loan officers and dealerships. High repossessions by loan officers and dealerships may be an indication that the application and/or approval process may need to be re-examined to see if modifications need to be made by the credit union or additional training provided to the loan officer and/or dealerships.

Below are several suggested reports covering the loan portfolio that a credit union may want to consider as part of their review of the lending area:

- **Loans Paid Ahead 2-Months And Greater** - The objective of reviewing a loans paid ahead report is to ensure the next payment due date is correctly stated and in accordance with the loan terms. The report is usually generated so that it includes all loans with a next payment due date two months or more into the future. Testing of the loans paid ahead report should investigate the following at a minimum:
 - * Payments made by the member, which are greater than their scheduled payment.
 - * Advanced due dates with no recent payments.
 - * Small balances with no recent payments - which could indicate an attempted loan pay-off.
 - * Deficiency balance not charged off
 - * Unauthorized loan due date advancing.
 - * Continuous due date changes to the same account
 - * Continuous changes by the same employee

Bumping due dates is a popular way a fraudster keeps loans from being reported on the delinquency list and therefore, the loans paid ahead report should be periodically reviewed to detect any unusual next payment due dates. Additionally, if it's the Board of Directors' intention to allow loans to be paid in advance, this should also be conveyed in the written loan policy.

- **Loans Rates >18% and < 3%** - Interest rates for loans should be equivalent to the original terms on the loan agreement between the member and a credit union. However, interest rates on loans could be different from the original terms on the loan agreement due to many reasons. Because of potential problems, the interest rates of loans should be tested on a periodic basis to ensure the information is correct and pursuant to the intended loan interest rate.



- **Accrued Interest Greater Than \$1,000** - There are several valid reasons why the accrued interest on a loan may be higher than the established benchmark. Some of these reasons include, but are not limited to, the following: the loan is on the delinquency list, the loan has a high balance (i.e., mortgage loan) and/or a high interest rate, the loan could be a student loan (interest is due at a later date), the loan has a balloon payment at maturity of the loan, or a credit union is receiving partial payments. If a credit union can explain any of the loans on its accrued interest report with one of the reasons listed above, it can eliminate that loan from its list without further investigation. Any remaining loans on the report should be researched to determine why they appear on the list.

- **Accrued Interest Greater Than The Payment** - This report generates all loans with accrued interest greater than the scheduled loan payment. The objective of reviewing this report is to ensure that these loans are correctly stated and in accordance with the specific terms of the loan note for each loan type. There are a number of valid reasons why the accrued interest on the loan may be higher than the payment, some of these reasons include, but are not limited to, the following:

- * Credit union is receiving partial payments
- * Loan is a single payment
- * Student loans (interest is due at a later date)
- * Loan has a balloon payment at maturity of the loan
- * Bumping the due date
- * Loan is a "charged-off" loan or partially charged off
- * Loan has been on the delinquency list for a period of time
- * Loan which only has principle payments

- **Zero Balance Loans with Accrued Interest** - Zero balance loans should not have any accrued interest. Therefore, a review of a report of zero balance loans with accrued interest should be examined to ensure there are no such accounts.

A detailed report of all zero balance loans with accrued interest should include: member name, member account number, current loan balance, current interest accrual, collateral code.

- **Loan File Maintenance Reports** – Loan file maintenance reports are reports that detail changes to selected fields of a member's loan, account, or other personal information; normally reflecting a "before" and "after" change of information. The types of information changes that would appear on a file maintenance report include but, are not limited to, changes in name, interest rates, address, phone number, frequency of loan payments, loan due date changes, additional individuals added to selected accounts, etc. However, loan file maintenance reports can be cumbersome to try to review and may result in the reports not being able to be reviewed timely or at all. We recommend the credit union try to create separate reports for the sensitive transactions listed below.

- * Due date changes
- * Address changes
- * Loan interest rate changes
- * Loan balance changes
- * Payment amount or frequency changes
- * Loan term changes



ABOUT US

Since 1979, Nearman, Maynard, Vallez, CPAs has provided auditing and consulting services exclusively to credit unions throughout the United States. Our dedication to the credit union industry has given us the unique ability to provide exceptional service at a reasonable price. Our primary objective is to assist our clients in accomplishing their goals through our experience, service, and commitment. If your Supervisory/ Audit Committee or Management is interested in obtaining information on the subjects in this issue or about our many services, call or email us today.

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All reports noted above should be independently reviewed by someone who does not have the ability to make these types of changes. Depending on a credit union's resources, the frequency of the above reports will vary but, should be reviewed at a minimum on a monthly basis.

Feedback from our clients who have implemented the suggestions above has shown that effective results can be achieved. In addition, working with the computer vendor can result in the specialized reports being developed based on a credit union's specific requirements. Given the potential for detecting fraudulent activity, we strongly recommend credit unions consider the recommendations listed above. Most of the reports are **proactive measures**, which should aid your credit union in monitoring this high-risk area.

*Cecil D. Maynard, CPA, MPA, CFE, FCPA, CFF, Partner
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2019 Credit Union Conferences

Nearman, Maynard, Vallez, CPAs will be "out and about" celebrating our 40th anniversary with the credit union community this year. If you plan on attending any of the following conferences, please stop by our booth. We would love to meet you and discuss your credit union's auditing needs.

- Cornerstone League—April 24-26, 2019—Austin, TX
- Tennessee Credit Union League—May 8-10, 2019—Nashville, TN
- Georgia Credit Union Affiliates - May 13-16, 2019 - Jekyll Island, GA
- Michigan Credit Union League—June 5-8, 2019—Detroit, MI
- League of Southeastern Credit Unions - June 19-21, 2019 - Orlando, FL
- ACUIA - June 18-21, 2019 - Denver, CO



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