

The Auditor's Report

ACH UPDATE

ACH Rules Changes Effective March 15, 2013:

- **IAT Modifications & Refinements** clarifies and enhances the rules to support more efficient processing of IAT entries.
- **Data Passing Rule** prohibits the sharing of certain customer information by Originators, Third-Party Service Providers, and ODFIs for the purpose of initiating debit entries that were not covered by the original authorization.
- **ODFI Return Rate Reporting** reduces the reporting period from 60 days to 30 days whereby the ODFI has to reduce its return rate below the threshold before a rules enforcement proceeding is initiated.
- **Incomplete Transactions and the Return of Funding Debit Entries** rule allows the return of a debit entry to a consumer account within 60 days of the settlement date for an incomplete transaction, which is where a Third Party Sender debits a consumer's account to collect funds, but does not pay the party which the payment is owed.



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A PUBLICATION OF

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Fraudulent Financial Reporting: Catch Them Before It's Too Late

Investors' confidence and reputation are valuable and priceless assets to all companies, therefore maintaining those assets require an investment in fraud detection within financial reporting.



reporting begins with pressure or opportunity. Pressure arises from goals not being met or from the "tone at the top," while opportunity is due to lack of internal controls and security.

Fraudulent Financial Reporting is a scam that is increasing every year in large numbers and percentages. The presence of fraudulent financial

According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO), revenue fraud increased from 50 percent of all cases to 60 percent of all cases between the two 10-year studies (1987-2007). The U.S. Securities and Exchange Commission (SEC) names the CEO and/or CFO for some level of involvement in 89 percent of the fraud cases.

Fraud affects all company sizes and normally is detected through the following red flags:

- Complex or unstable organizational structure
- Significant cash flow changes
- Improper revenue recognition
- Recording fictitious revenues or assets
- Asset overstatements and/or expenses understatement
- False acquisitions or netting amounts of miscellaneous items

- Disguised transactions through related parties

It is highly recommended to implement controls, policies, and procedures to prevent and/or detect fraud before it occurs, such as:

- Implement internal controls for segregation of duties for postings and authorization
- Implement a fraud policy and fraud hotline
- Form an independent audit committee
- Improve the "tone at the top" that demonstrates ethical behavior for the entire company
- Schedule annual examinations and audits of financial statements by an outside party

Executing the recommendations are the first steps to reducing, preventing, and detecting fraud within your company's financial statements. Consistency in controls and policies will aid in catching them before it is too late.

Alysha Pruitt, Auditor
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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 credit unions 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, & 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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Recognizing the Risks of Cash

The very nature of cash and cash equivalents is usually considered a high risk area and requires good internal controls and careful monitoring. It is also pointed out in the Association of Certified Fraud Examiners, *Report to the Nations on Occupational Fraud and Abuse* that the presence of anti-fraud controls is notably correlated with significant decreases in the cost and duration of occupational fraud schemes.

Cash usually includes cash on deposit in other depository institutions, cash on hand, and cash equivalents. Cash equivalents are short-term, highly liquid instruments that are both easily convertible to known amounts of cash. Types of cash and cash equivalents include, but are not limited to, cash, teller cash, vault cash, ATM cash, petty cash, traveler's checks, money orders, cashier's checks, investments, movie tickets, stamps, etc.

Risk is defined as the potential that events (expected or unanticipated) may have an adverse impact on a credit union's earnings, capital, or credibility. Existence of risk is not, by itself, a reason for concern. Rather, management must consider whether the risks are warranted. Risks are warranted if they are understandable, controllable, and within the credit union's capacity to readily withstand adverse performance. The area of cash and cash equivalents historically is a low risk area compared to other areas of the credit union. However, continuous coverage in the area of cash and cash equivalents must be part of the internal control consideration due to the nature of cash.

As can be seen in the "Fraud Triangle" below, three items are usually needed for an embezzlement of cash to occur; an *opportunity*, *pressure*, and the individual's *rationalization* of a situation. The definitions of these terms are as follows:



Opportunity: Circumstances exist for example, the absence of controls, ineffective controls, or

the ability of Management to override controls that provide an opportunity for fraud to be perpetrated.

Pressure: Management or other employees may have an incentive or be under pressure, which provides a motivation to commit fraud.

Rationalization: Those involved in a fraud are able to rationalize a fraudulent act as being consistent with their personal code of ethics. Some individuals possess an attitude, character, or set of ethical values that allow them to knowingly and intentionally commit a dishonest act.

The above example relates to individuals who are tellers and how the three areas could effect a potential embezzlement. As can be seen in the matrix above, all three items (opportunity, pres-

	Opportunity	Pressure	Rationalization
1.	I have access to the vault.	I need the money.	The CU has excess cash.
2.	I have access to the vault.	I need the money.	I do not want to go to jail.
3.	I do not have access to the vault.	I need the money.	The CU has excess cash.
4.	I have access to the vault.	I do not need the money.	The CU has excess cash.

sure, and rationalization) need to exist in order for a potential embezzlement to occur. The "shaded" explanation in three of the rows provides an example where the likelihood of the probability of embezzlement would not occur. Therefore, in the matrix above, embezzlements would most likely occur when conditions in row one exist. This matrix could be developed for specific areas for virtually all conditions and/or situations where fraud could potentially exist.

Based on the numerous risks affecting cash and cash equivalents these areas should be audited on a regular basis. Stay tuned for our follow article in the next issue of *The Auditor's Report* where we will show you how to mitigate your risk through a cash audit.

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 Nearman, Maynard, Vallez, CPAs, P.A.*

2013 Conferences

Nearman, Maynard, Vallez, CPAs will be "out and about" visiting 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 discuss your credit union's auditing needs.

- Georgia Credit Union Affiliates - May 8-11, 2013 - Savannah, GA
- CUNA CFO Council - May 19-22, 2013 - Chandler, AZ
- League of Southeastern Credit Unions - June 12-15, 2013 - Orlando, FL
- ACUIA - June 25-28, 2013 - San Francisco, CA
- AICPA National Conference on Credit Unions - October 21-23, 2013 - Las Vegas, NV
- CUNA Supervisory Committee & Internal Audit Conference - December 8-11, 2013 - Las Vegas, NV