

the Competitive Edge

for Credit Unions

Looking For The Silver Lining

Financial Crisis Creating Opportunities

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The financial crisis has severely damaged many large financial institutions, as well as economies around the globe. But for many credit unions, this dark cloud may have a silver lining.

Weathering The Storm

The subprime mortgage market's collapse led to some of the largest financial institution failures in U.S. history and forced several venerable investment banking and mortgage companies to shut their doors. Many of the institutions that have survived have severely curtailed or eliminated lending secured by single-family homes. Your credit union may be positioned to fill the void.

If, like most credit unions, yours steered clear of the subprime mortgage market, it's likely that your residential mortgage business remains relatively healthy. The key term here, of course, is "relatively." Your credit union certainly isn't immune to declining housing prices, tightening credit and a struggling economy that's affecting all financial institutions. The good news is that you managed to stay in the eye of the subprime storm, giving you an edge over many of your larger competitors and putting you in a good position to grab market share as the economy recovers.



Forecast Hazy

Although the economy's precarious state should concern all businesses, credit unions may have reason to be optimistic, as indicated by a recent Annual Real Estate Lending Survey Report, published in February 2008. Keep in mind that the survey was conducted after the subprime mortgage collapse, but before the events that led to the government bailout.

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*(Look For The Silver Lining—
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At that time, 39% of financial institutions expected single-family lending to increase, while another 39% expected it to stay the same. As the Annual Real Estate Lending Survey observed, “This forecast is consistent with the often expressed view that credit unions are well positioned to gain market share as other lenders falter.”

Indeed, the nature of utilizing a credit union gives you a decided advantage. As larger players exit the market, local financial institutions are increasingly viewed as the best alternative. And despite an overall decline in residential mortgage applications, some credit unions have seen increased application numbers. What’s more, without large financial institutions underbidding you, your credit union may even enjoy a more favorable pricing environment.

The potential benefits for your credit union extend beyond residential lending. In the wake of the subprime collapse, credit unions are also re-evaluating their member business lending programs. This is likely to open up new opportunities for local credit unions. The industry also may see growth in deposits as weary investors seek shelter from the volatile stock market.

Bring An Umbrella

The forecast for credit unions seems relatively clear, but conditions can change quickly, so it’s important to exercise caution. Your credit union shouldn’t abandon the conservative lending standards that helped shelter it from the subprime mess in the first place. Much of the new lending business created by the withdrawal of large financial institutions from local markets involves greater credit



risk. So although these borrowers aren’t considered subprime, many of them have credit issues or would have been candidates for low-documentation loans at larger institutions.

As you take advantage of opportunities to increase your market share and boost pricing, don’t lose sight of credit quality. Maintain your credit standards, pay attention to risk management and look out for business and economic trends that may harm your members. These days, seemingly strong members can become problem borrowers overnight. Closely track loan quality statistics and other data that can signal borrower trouble. If your credit union isn’t currently involved in residential lending, these opportunities may be attractive. But keep in mind that residential lending involves relatively complex

underwriting methodologies and a rigorous regulatory framework. The cost of noncompliance can easily wipe out any potential earnings. If you lack the in-house expertise to manage compliance with residential lending regulations, be sure to engage qualified outside consultants to assist you.

Enjoy The Weather

Despite the gloomy economy, your credit union has a unique opportunity to build its business. To take advantage of the chance, ramp up your marketing efforts and renew relationships with realtors, appraisers, homebuilders and other referral sources. So long as you continue to follow sound lending practices, your credit union will be prepared to weather this and future economic storms.

Security Interests

Is Your Online Information Protected?

As online banking continues to grow in popularity, even small credit unions are offering members Web access to at least some of their products and services. But with this convenience comes an unwelcome byproduct: the threat of unauthorized access by hackers and identity thieves.

Information security is critical to maintaining member relationships. Unless they're confident that their money and personal data are safe, members may take their business elsewhere. So it's critical that you do everything possible to prevent online thieves from breaching your security.

What's Your Risk Profile?

Despite the importance of information security, throwing money at the problem isn't the answer. And while there's virtually no limit to the security measures you can put into place, no credit unions has unlimited financial or staffing resources to dedicate to the project.

The first step, therefore, is to conduct a risk assessment to identify the areas where your institution is most vulnerable and to focus your resources in those areas. Every credit union is different, so an appropriate allocation of resources depends on a variety of factors, including the types of online services you offer and your credit union's size, location and operational complexity.

It's a good idea to hire an independent third party to conduct the risk assessment. Your own staff could view the credit union's risks in terms of particular individuals rather than the activities themselves.

What Type Of Security Do You Need?

Once you understand your credit

union's risk profile, you can design an information security plan tailored to meet its needs. Security measures you might consider include:

- Access controls to authenticate users and prevent access by unauthorized individuals,
- Controls that prevent employees from providing member information to unauthorized individuals,
- Restricted access to physical locations that contain member information, such as buildings, computer facilities and record storage facilities,
- Encrypted electronic member information, whether in transit to offsite storage or stored on networks,
- Background checks on employees who are responsible for, or have access to, member information,
- Dual control procedures and segregation of duties for employees who have access to member information,
- Monitoring systems and procedures to detect and investigate suspicious activities, and
- Measures to protect member information from destruction, loss or damage from fire, water damage, power or technological failures, or other environmental hazards.

These are only a few examples of the security measures you can take to protect member information. The key is to identify the places where you're most vulnerable and to adopt measures that target those spots.

A Good Investment

In the end, the time and expense you

put into an assessment of your security risks — and controls to minimize them — will be a rock-solid step toward protecting your members and your relationship with them. Technology as revolutionary as what the credit union industry has experienced in the last decade demands nothing less.

SHOULD YOU OUTSOURCE?

As security threats become more sophisticated and member information harder to protect, many credit unions are turning to managed security service providers (MSSPs) for help. These companies can provide greater security measures than you might generate internally because they monitor the latest hacker strategies and typically offer cutting-edge technology solutions.

Many MSSPs provide around-the-clock monitoring to detect suspicious activities and repel any actual attacks. If you use an MSSP, however, you still need to dedicate internal resources to information security — although external threats are a serious concern, many of the most damaging attacks come from within.

Significant Changes To Form 990

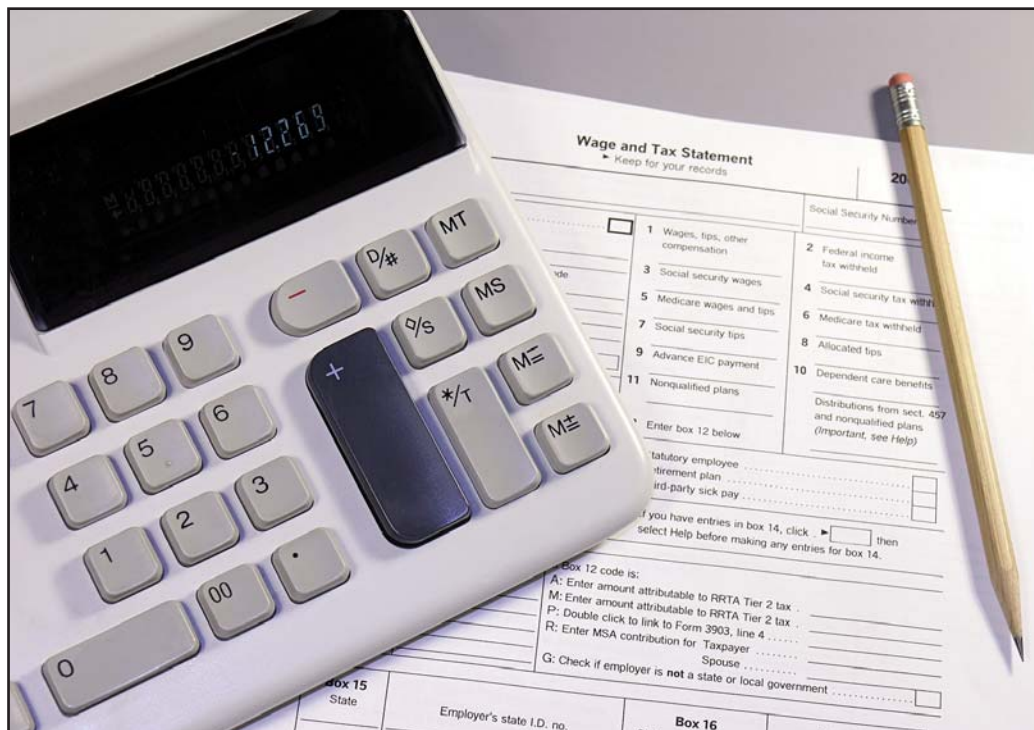
IRS Revised Information Required for 2008 Filings

After a three year project, the IRS has extensively revised the Form 990. The objectives of the revision were to enhance transparency, promote compliance and minimize filing burden. The new form's instructions offer a number of tools, examples, and comprehensive line by line instructions which are designed to promote uniform reporting and help organizations report accurate and complete information.

The new form is a significant redesign in format and content compared to the prior form. Major changes include a front page summary that provides a snapshot of key financial and operating information, a governance section, a revised compensation section and related organizational reporting. The new form also replaces existing "unstructured attachments" with formal schedules. The number of schedules increased from 2 to 16. Credit unions will not have to complete all of these schedules depending on their situation.

Inquiries related to executive compensation have significantly expanded. The credit union will have to:

- Describe the process for determining compensation for the CEO and other officers or key employees of the organization. Executive compensation reporting in the core form and Schedule J now requires amounts from W-2's and/or 1099-Misc forms.
- Provide answers to additional executive compensation questions included on a new separate schedule (Schedule J).



- Report employees receiving total compensation of \$100,000 or more from the organization.
- Provide additional reporting for former officers, directors, trustees and the highest compensated employees as required by the level of compensation.

There are many additional inquiry questions also requiring description in the new form, some of which include:

- Are annual disclosures of conflicts required for officers, directors, trustees and key employees? Does the credit union regularly and consistently monitor and enforce compliance with the conflicts of interest policy?
- Does the credit union make (and if so how) it's governing

documents, conflict of interest policy and financial statements available to the public?

- What is the process the credit union utilizes to review the Form 990 before filing?
- Did the credit union contemporaneously document the board meetings held or written actions undertaken during the year?

The new IRS Form 990 filing requirements are effective for reporting in years beginning in 2008. That would include applicable state chartered credit unions' 2008 filing. The filing deadline for a December 31, 2008 year-end is May 15, 2009. If you lack the in-house expertise in completing this form, be sure to engage qualified tax consultants to assist you.

Prevent Employee Fraud

Covering All The Angles

Employee fraud is a significant threat to U.S. businesses, yet few credit unions give it the attention it deserves. One reason is that credit unions tend to focus on external threats, such as check fraud and identity theft, which make headlines and alarm members. The key to combating employee fraud is to understand the conditions that lead to it, also known as the “fraud triangle.”

Focus on Prevention

In its 2008 Report to the Nation on Occupational Fraud & Abuse, the Association of Certified Fraud Examiners (ACFE) estimated total occupational fraud losses in the U.S. at nearly \$1 trillion a year, or 7% of annual revenue for a typical business. The ACFE surveyed companies in a wide range of industries, but credit unions and other financial services companies were hit most frequently, suffering 14.6% of all internal frauds. And their median loss was \$250,000 per case, nearly 43% higher than the industrywide median.

The most effective way to reduce fraud is through prevention. According to the ACFE, once a fraud is committed, it's difficult to recover your losses. Fraud victims fully recovered their losses in only one-sixth of the cases the ACFE studied, and those tended to be smaller cases. More than 42% of businesses recovered nothing and another 23% recovered less than one-fourth of what was stolen from them.

Your fraud prevention strategy should address all three sides of the fraud triangle, or the elements that make fraud possible:

Opportunity -

Employees steal from their employers because they can. But strong internal controls can dramatically reduce opportunities for fraud.

Other strategies include mandatory vacations, which make it more difficult for potential fraudsters to cover their tracks, and requiring employees to provide members with receipts, which limits opportunities to steal funds from deposits.

The appropriate strategies for your credit union depend on your particular circumstances. But whichever controls you select, they will be effective only if you apply them correctly and consistently.

Pressure - When it comes to fraud, you may have a “it-can't-happen-to-me” attitude, especially if your credit union is small and you know and trust your employees. But financial pressure can be a strong motivator that tempts otherwise honest employees to steal. According to the ACFE, 83% of internal frauds are committed by first-time offenders.

Pressure can come from a variety of sources, including gambling debts, drug or alcohol abuse, medical bills or other debts, divorce, or simply the need to maintain a certain lifestyle. Employers can help relieve this pressure by compensating employees fairly, providing adequate medical insurance and offering Employee Assistance Plans that provide counseling and other help to



troubled employees.

Rationalization - Because most fraud perpetrators are otherwise honest people who find themselves in desperate circumstances, they need to justify illegal acts to themselves. Common rationalizations include:

- “The credit union doesn’t pay me enough. I deserve more.”
- “I’m only borrowing the money.”
- “The credit union has so much money, it won’t even miss it.”
- “Lots of people do it.”

You can do several things to reduce the chances that employees will rationalize fraud. One, of course, is offering market-competitive compensation. But it’s also important to conduct background checks on prospective employees. Strive to hire people who are proven to have a high degree of integrity and to be motivated by career opportunities and personal satisfaction rather than compensation alone.

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Other strategies include developing a strong corporate culture that values integrity, providing employees with ethics and fraud awareness training, and disciplining employees who engage in misconduct.

Overlook Detection

Even though prevention is the best medicine, taking action to detect fraud and punish wrongdoers serves as a strong deterrent. Methods for detecting fraud include internal controls, internal and external audits, tips from employees and others, and observing employees for suspicious behavior or sudden lifestyle changes.

According to the ACFE, however, fraud is more likely to be detected by a tip than by any other means. Thus, maintaining an anonymous fraud hotline is a very powerful tool for catching fraud. For this strategy to work, it's important to build awareness of the hotline among employees, members, vendors and others who deal with your credit union. Not only do companies with hotlines detect fraud much more quickly, but their median fraud loss is 60% less than that of companies without a hotline.

The most effective strategy is to deploy a variety of antifraud controls. The ACFE reports that the median fraud loss in organizations that conduct surprise audits, for example,

is more than 66% lower than that of those that do not. Other effective controls include job rotation/mandatory vacation (61% loss reduction), employee support programs (56% reduction) and fraud training for managers/executives (55.9% reduction).

Assess Your Risk

When all is said and done, you will want to conduct a risk assessment to identify the areas where your institution is most vulnerable and where the risk of loss is greatest. This will allow you to focus your fraud prevention resources where they'll do the most good



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