THE RISKS OF AUDITING A CREDIT UNION

Auditing a credit union is unlike auditing other types of corporations or institutions:

- they are akin to banks, but are regulated under a different legislative framework;
- many are relatively small and are run with some informality; and
- perhaps because of this, bonds of ethnicity or community sometimes impair the objectivity of credit union employees, managers, and directors.

As a result, accountants who conduct an audit of a credit union must ensure that they understand the regulatory and business framework of credit unions, and be vigilant about the separation of functions within a credit union, and their own independence from the credit union.

The purpose of this article is to identify certain particular risks that accountants face when conducting an audit of the financial statements of a credit union.

Background

Credit unions are community-based, informal 'banking' facilities. Most credit unions were established in the 1940's and 1950's, as a way for people in small towns, members of a particular ethnicity, or employees of a particular organization, to lend each other money, and to avoid the traditional banking institutions.

The credit union system grew, evolved, and is far more 'professional' and institutionalized than it was at the outset. Most particularly:

- the provinces have legislation governing credit unions;
- deposits are protected by deposit insurers; and
- the credit unions are regulated by the provincial governments.

More recently, there has been a wave of mergers, which has significantly reduced the number, but increased the average size, of credit unions since 1990.

Risks in Conducting an Audit of a Credit Union

It is important for the auditor to make no assumptions about the competence of the directors of the credit union. Most credit unions are professionally governed by experienced, skilled directors. However, the directors of some, particularly smaller, credit unions are volunteers, and have no accounting skills, or experience governing or managing a financial institution. The authors are familiar with occasions in which a credit union's board of directors has been a 'rubber stamp' for management. In these cases, the directors simply relied on the skills and good faith of management to ensure that the credit union was complying with the applicable legislation and that loans were proper when, in fact, they were not.

Auditors should also be vigilant about the possibility of fraud. The relative informality with which some smaller credit unions are run can provide an opportunity for fraud by credit union employees. For instance, in one case with which the authors are familiar, the manager of a small credit union defrauded $2 million from the institution over a period of 10 years. The manager's thorough knowledge of the credit union's affairs and accounting system, her strong personality, and her apparent trustworthiness lulled the directors into, in effect, delegating all significant decisions to her. The manager was virtually unsupervised and unaccountable.

The risk can be heightened when the auditor is also a member of the same community as the members of the credit union. The auditor will then often feel pressure to share the trust and confidence of the credit union directors in the credit union management. This creates a 'golden opportunity' for credit union management to avail him or herself of the assets of the credit union. examples of these 'opportunities' include:

- improperly authorized loans to related parties, or even fictitious loans to disguise credit union funds being misappropriated;

- use of bearer instruments, such as Treasury Bills, which are owned by the credit union, as security for borrowings from other institutions; and

- of course, simply misappropriating funds from the credit union through a series of relatively small, but frequent, payments to the benefit of the credit union manager/employee.

Small credit unions are also susceptible to fraud because employees often perform more than one function. For instance in many credit unions, the bank reconciliation is supposed to be conducted by one employee, and reviewed by another. Some credit unions do not have the staff to handle both functions, so that the employee conducting the bank reconciliation in effect 'reviews' his or her own work. Simply put, a bank reconciliation prepared under such circumstances cannot be relied upon by the auditor of a credit union.

The most common situation which exposes the auditor to liability for fraud is when a discrepancy comes to the attention of the auditor during field work, but the auditor is satisfied to accept the explanation of management without proceeding to obtain objective and substantive verification. In one such circumstance, a physical count conducted by the auditor of bearer instruments revealed that several of them were not present; the manager of the credit union advised the auditor that the missing instruments were in another safety deposit box, and the auditor simply made a note of that in the working paper file. All too often in a claim against an auditor of a credit union, the working papers will include such notations of 'explanations' provided by management.

In short, in the audits of credit unions, it is prudent for the auditor to plan the audit so as to put as little reliance as possible upon management.

Regulatory Bodies

Auditors should also take care to place as little reliance as possible on the reviews conducted by credit union regulators and deposit insurer. Credit union regulators and deposit insurers in several provinces have the authority to examine a credit union's affairs,[1] but are immune from lawsuits relating to any act or omission done in good faith.[2] While credit union regulators or deposit insurers may conduct periodic reviews for their own purposes, the auditor should not rely on them because the regulator cannot be held accountable for any mistakes made in the course of those reviews.

Conclusion

Auditing credit unions can be sources of risk for auditors. Some credit unions are managed informally; and certain directors do not have the necessary governance skills. The auditor should ensure that he/she and the credit union understand the terms of the audit engagement before auditing a credit union. Then, in conducting the audit, the auditor should be vigilant in following the audit plan, and in maintaining as much independence as possible from credit union management.

About the Authors

Written by Sean Lawler, B.Sc., LL.B. and Sandra E. Dawe, B. Comm., LL.B.

Sandra and Sean are both Partners with Shibley Righton LLP and have worked with AICA Services Inc. for many years, providing defence services in claims against Chartered Accountants. They also practice in the area of commercial litigation.

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[1] See for instance (without limitation): s.272 of Ontario's *Credit Unions and Caisses Populaires Act, 1994*, S.O. 1994, ch. 11 (the "Ontario Act"); s.210 of British Columbia's *Financial Institutions Act* (the "BC Act") , RSBC 1996, ch 141; s.459 of Saskatchewan's *Credit Union Act, 1998, Statutes of Saskatchewan, 1998*, ch. 45.2 (the "Saskatchewan Act")

[2] See, for instance (without limitation): s.253 of the Ontario Act; ss. 216 & 243 of the BC Act; and s. 432 of the Saskatchewan Act.