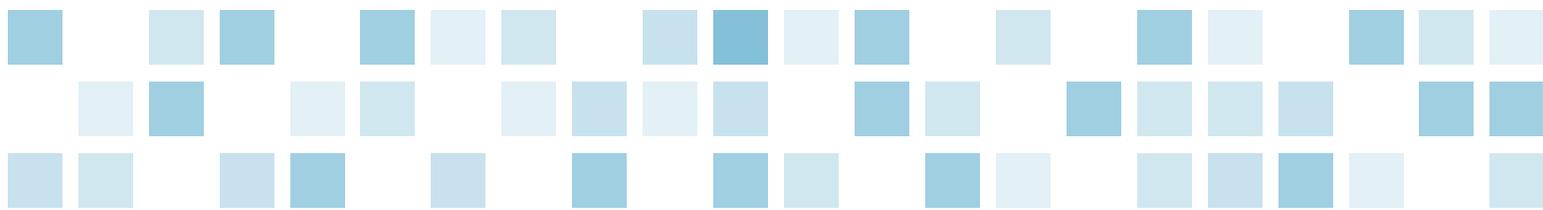


# Creating a culture of integrity is the cornerstone of fraud prevention



## Prepared by:

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October 2012

The financial, reputational, psychological and social implications of fraud not only can cut across a credit union's entire operation; they also extend outside the organization and can damage its position within its market and community. The cost of fraud is not measured in dollars alone – it is also measured in lost productivity, sullied reputations and damaged member relationships. Fraud can destroy an institution.

An effective anti-fraud program doesn't start with hard controls like reporting methodologies or internal controls and procedures. Rather, it starts by establishing and nurturing a culture of integrity. That culture is the cornerstone of an effective anti-fraud environment. Without that foundation, hard controls are much less effective.

Why? Detection, deterrence and prevention are the three elements of an effective fraud prevention strategy. Hard controls are most effective in detecting and deterring fraud, and can help prevent fraud through operational controls that reduce opportunities for fraud to take place. However, fraud can be difficult to detect or deter because it often involves falsification of documents or collusion among management, employees or third parties. In a credit union with a strong culture of integrity, such behaviors are far less likely to occur, and individuals engaging in them are less likely to find others to collude with. These individuals are instead more likely to be reported. Thus, focusing on embedding a culture of integrity throughout your organization serves to both deter and prevent fraud, which is far less expensive than detecting and investigating it.

Research indicates that the most effective way to implement measures to reduce wrongdoing is to base them on a set of core values that are embraced by the entire organization. These values provide an overarching message about the key principles guiding all employees' actions. This provides a platform for a more detailed code of conduct that gives specific guidance about permitted and prohibited behavior based on applicable laws and the organization's values. Management needs to clearly state that all employees will be held accountable to act within the organization's code of conduct. An effective code of conduct should be developed in a participatory and positive manner so that both management and employees have ownership of its content.

While credit unions of all sizes must create and maintain a culture of integrity, the methods of doing so can vary. Programs and controls that are effective in smaller, less-complex credit unions and the formality of their application are likely to differ from the approach taken at larger institutions. Whether your institution is large or small, there are key steps to consider in building and nurturing a culture of integrity:

- Setting the tone at the top
- Creating a positive workplace environment
- Hiring and promoting the right employees
- Training
- Ensuring employee confirmation and acknowledgement
- Ensuring appropriate oversight

## Setting the tone at the top

Research in moral development strongly suggests that honesty is best reinforced when an organization's leaders set the right example — by the tone at the top. Directors and officers set that tone within a credit union. The management of a credit union cannot act one way and expect others in the organization to behave differently.

In many cases, particularly in larger credit unions, management must both behave ethically and openly communicate its expectations for ethical behavior throughout the organization. Such communications are vital because most employees are not in a position to observe management's actions. Management must show employees through its words and actions that dishonest or unethical behavior will not be tolerated, even if it would benefit the credit union. Moreover, management should strive to ensure that all employees are treated equally, regardless of their positions.

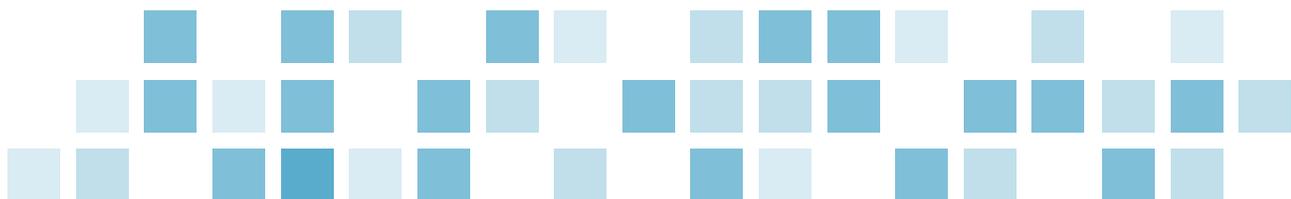
## Creating a positive workplace environment

Employee satisfaction in the workplace directly affects the likelihood of fraud. Research indicates that fraud occurs less frequently when employees have positive feelings about their employer and more frequently when they feel abused, threatened or ignored. The lower an organization's morale, the more likely that fraud will occur. Factors that may increase the risk of fraud include:

- Top management that does not seem to care about or reward appropriate behavior
- Negative feedback and lack of recognition for job performance
- Perceived inequities in the credit union
- Autocratic, rather than participative, management
- Low organizational loyalty or feelings of ownership
- Unreasonable budget expectations or other financial targets
- Fear of being punished for delivering bad news to supervisors or management
- Less-than-competitive compensation
- Poor training and promotion opportunities
- Lack of clear organizational responsibilities
- Poor communication practices

A credit union's human resources department is instrumental in helping to build a culture of integrity and a positive work environment. Human resource professionals should spearhead efforts to implement specific initiatives that help eliminate the negative workplace practices mentioned above and that instead support a positive work environment, including:

- Recognition and reward systems that are aligned with goals and results
- Equal employment opportunities
- Team-oriented, collaborative decision-making policies



- Professionally administered compensation programs
- Professionally administered training programs and an organizational focus on career development

Employees, too, should be empowered to help create a positive workplace environment. They should be given the opportunity to provide input to the credit union's code of conduct to help ensure that it is relevant, clear and fair. Involving employees in defining the code of conduct will increase the likelihood that they will help enforce it.

Employees should be trained to recognize decisions with significant legal or ethical implications, and should have direct access to the resources needed to address these implications. They should also be encouraged to raise concerns, anonymously if preferred and without any fear of retribution, about potential violations of the credit union's code of conduct. Many credit unions have dedicated channels through which employees can confidentially report any fraud or ethics concerns, such as a telephone hotline monitored by an ethics officer or other trusted individual.

## Hiring and promoting appropriate employees

Each employee has a unique set of values and a personal code of ethics. When faced with sufficient pressure and a perceived opportunity, some employees will behave dishonestly. The threshold at which dishonest behavior starts, however, varies among individuals. Credit unions should develop human resource policies that minimize the chance of hiring or promoting individuals prone to dishonesty, especially for positions of trust. Proactive hiring and promotion procedures may include:

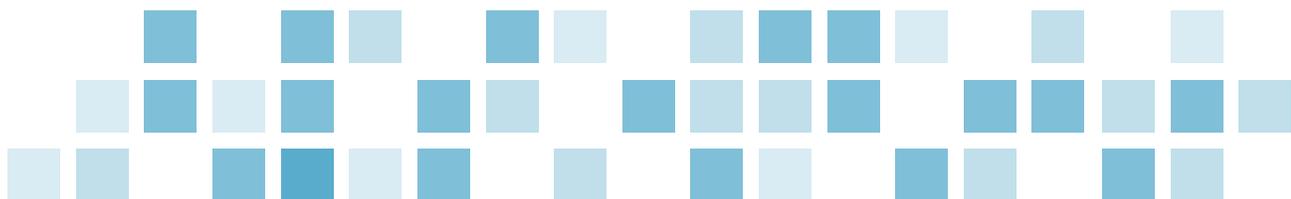
- Conducting background investigations on individuals being considered for employment or for promotion to a position of trust.
- Thoroughly checking a candidate's education, employment history and personal references.
- Periodic training of all employees about the credit union's values and code of conduct. Most internal frauds at credit unions are committed by long-term employees because they have the experience, knowledge, responsibilities, access and trust to commit fraud. Therefore, it is vital to reinforce values and ethics throughout every employee's career.
- During performance reviews, including feedback on how employees have contributed to an appropriate workplace environment and performed according to the credit union's values and code of conduct.
- Continual objective evaluation of compliance with the credit union's values and code of conduct, with violations being addressed immediately.

## Training

All new employees should be trained on the credit union's values and its code of conduct. This training should explicitly cover expectations of all employees regarding:

- Their duty to communicate certain matters
- A list of those matters, including actual or suspected fraud, along with specific examples
- Training on how and to whom to communicate those matters

This training should include direct reinforcement from senior management, and also should cover fraud awareness. The tone of the training should be positive but should stress the damage that fraud can do to the credit union and its employees.



Fraud-related training should be an ongoing part of every employee's career development. All employees should receive regular refresher training reinforcing the institution's core values and the employee's responsibilities. Consider adding additional training for certain positions, such as purchasing agents or employees with financial reporting responsibilities. Training should be specific to an employee's level within the organization, geographic location and assigned responsibilities. For example, training for senior manager-level personnel would be different from that of nonsupervisory employees, and training for purchasing agents would be different from that of sales representatives.

## Ensuring employee confirmation and acknowledgement

Management needs to clearly articulate that all employees will be held accountable to act within the credit union's code of conduct. All employees should be required to sign a code of conduct statement annually, at a minimum.

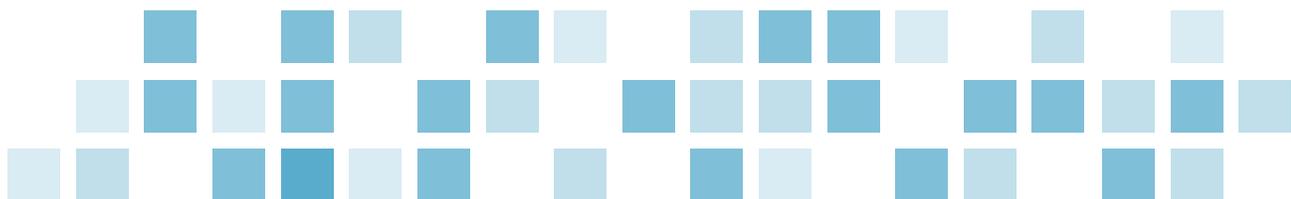
Requiring periodic confirmation by employees of their responsibilities not only reinforces the policy but can also deter individuals from committing fraud and help to identify problems before they become significant. Confirmations may include statements that the individual understands the credit union's expectations, has complied with the code of conduct, and is not aware of any violations of the code of conduct other than those the individual lists in his or her response. Although people with low integrity may not hesitate to sign a false confirmation, most people will want to avoid making a false statement in writing. Honest individuals are more likely to return their confirmations and to disclose what they know, including any conflicts of interest or other personal exceptions to the code of conduct. The organization should follow up aggressively with any employees who fail to return their confirmation.

The consequences of fraud must be clearly communicated throughout the credit union. For example, a strong statement from management that dishonest actions will not be tolerated and that violators may be terminated and referred to the appropriate authorities establishes clear consequences and can be a valuable deterrent. Communicating to all employees – but on a no-name basis – any disciplinary actions taken against employees who violate the code of conduct can be an effective deterrent since it increases the perceived likelihood that violators will be caught and punished. Such communications also demonstrate that the credit union is committed to an environment of high ethical standards and integrity.

## Ensuring appropriate oversight

A supervisory committee, in concert with the board of directors, should evaluate management's identification of fraud risks, implementation of anti-fraud measures and creation of the appropriate tone at the top. The supervisory committee typically has the authority to investigate any alleged or suspected wrongdoing brought to its attention. Most supervisory committee charters empower the committee to retain legal, accounting and other professional advisers to consult with the committee and assist in its investigations.

Active oversight by the supervisory committee reinforces management's commitment to creating a culture with zero tolerance for fraud. The supervisory committee's oversight not only helps ensure that senior management fulfills its responsibilities, but also serves as a deterrent against members of senior management engaging in fraud themselves by increasing the likelihood that such actions will be reported by other employees or discovered by the committee itself.

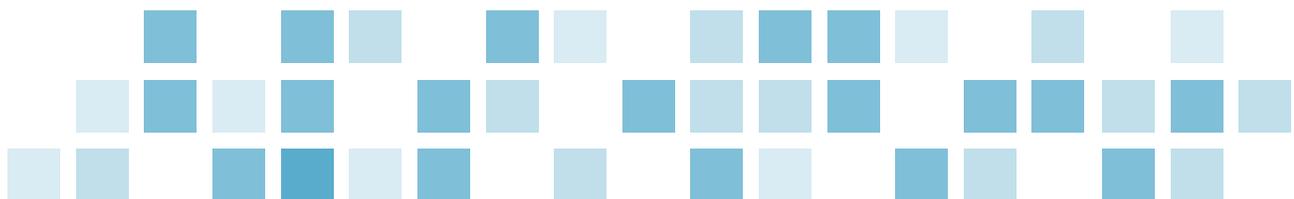


As mentioned previously, the credit union should provide a channel for employees to report fraud or any other suspected violation of the code of conduct. The supervisory committee should periodically review the nature, status and disposition of all reports to that channel, as well as any other instances of fraud or unethical conduct. This information also should be provided to the full board of directors.

If senior management is involved in fraud, the next layer of management may be the most likely to be aware of it. As a result, the supervisory committee and other directors should maintain open lines of communication with members of management one or two levels below senior management to assist in identifying or investigating fraud at the highest levels.

## Conclusion

Credit unions must make this message clear – every employee is responsible for helping to prevent and deter fraud, whether internal or external. Building and continually reinforcing a culture of integrity is the first and most important step to a successful fraud prevention strategy.



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