



# Internal Control Systems for Cooperatives

Processes, Procedures, and Tools

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## What is Internal Control?



What is internal control?

Internal controls are the mechanisms, rules, and procedures implemented by a company to ensure the integrity of financial and accounting information, promote accountability, and prevent fraud.

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## Why internal control is important to credit unions?

Ensure integrity, relevance & reliability of information.

Safeguard assets – members' interest.

Prevent and detect fraud & error.

Maintain efficient and effective use of resources.

Compliance with management policies.

Compliance with external regulations.

The objectives of an internal control system are to:

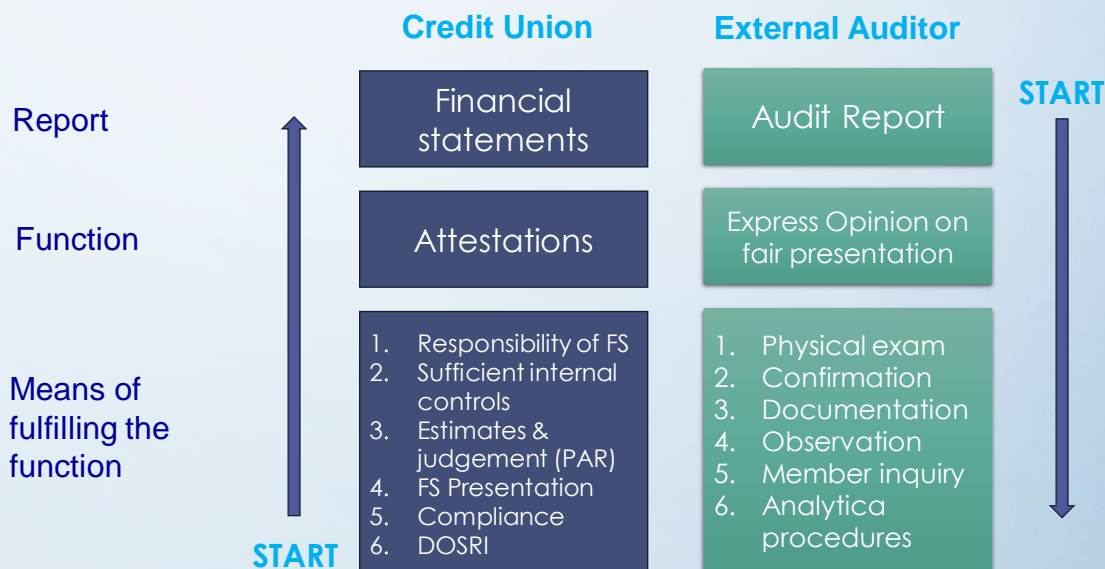
1. Ensure the integrity,
2. relevance and reliability of information.
3. Safeguard the assets or members' interest
4. Detect and deter fraud and error.
5. Maintain efficient and effective use of resources.
6. Ensure compliance with both management policies and external regulations.



	<b>Internal Audit</b>	<b>External Audit</b>
<b>Focus</b>	Enhance and protect organizational value.	Fair presentation of Financial Statements.
<b>Review &amp; testing level</b>	Lower	Higher
<b>Range of Risks</b>	Broad	Narrow
<b>Time horizon</b>	Current	Historical data
<b>Issue description</b>	Quantifiable & non-Quantifiable	Quantifiable
<b>Primary audience</b>	Board & management	Public and members
<b>Materiality focus</b>	Efficiency, member service, sustainability, safety and soundness	Financial reporting
<b>Scope of Work</b>	Operations	Financial records



## What the auditor does . . .



The attestations of management to the financial statements typically include various assertions and statements made by the management regarding the accuracy, completeness, and fairness of the financial statements. While the specific language and content may vary, here are some common attestations that management may make:

**1. Responsibility for Financial Statements:** Management asserts that they are responsible for the preparation and fair presentation of the financial statements in accordance with generally accepted accounting principles (GAAP) or an applicable financial reporting framework.

**2. Internal Control:** Management may state that they have established and maintain an adequate system of internal controls over financial reporting to ensure that the financial statements are free from material misstatement, whether due

to fraud or error.

**3. Estimates and Judgments:** Management acknowledges that the financial statements include estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses. They affirm that they have made these estimates in good faith and based on the best available information.

**4. Financial Statement Presentation:** Management confirms that they have selected appropriate accounting policies and applied them consistently. They may also assert that they have made disclosures that are sufficient to enable users to understand the basis of preparation and significant accounting policies.

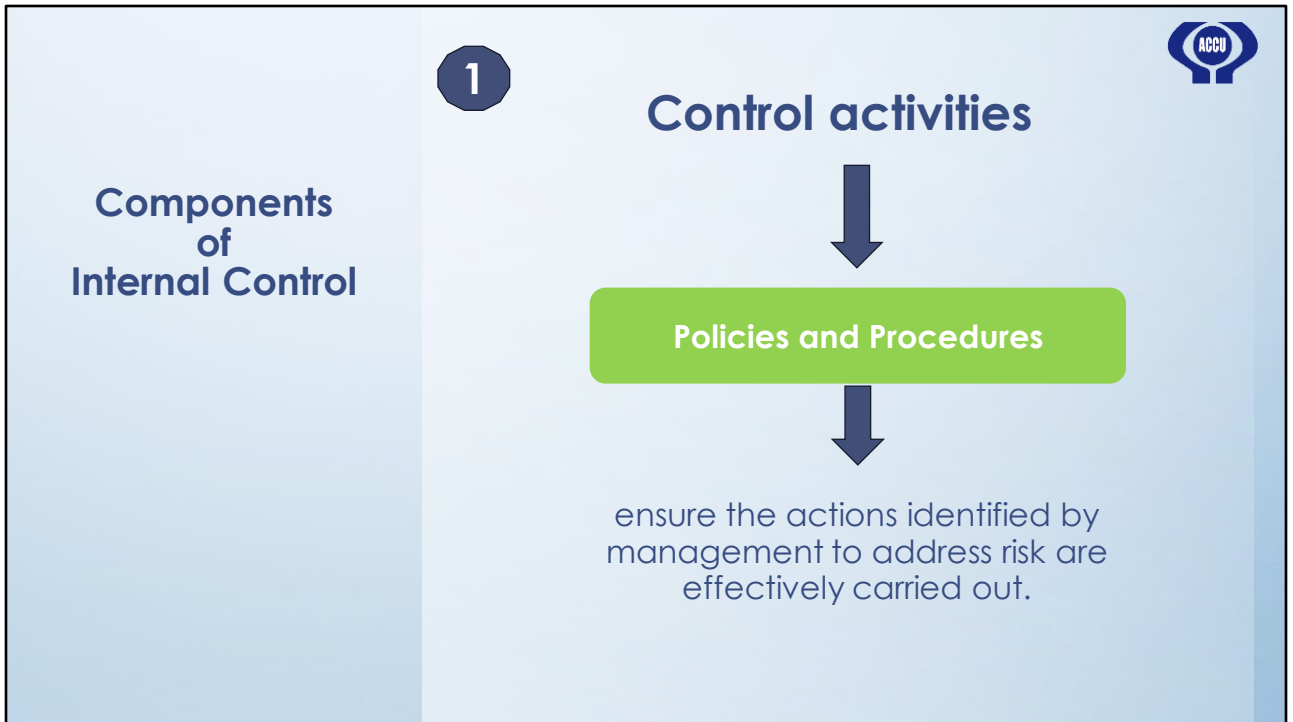
**5. Going Concern:** Management may make a statement regarding their assessment of the entity's ability to continue as a going concern. If there are uncertainties about the company's ability to continue, they should disclose these uncertainties.

**6. Compliance with Laws and Regulations:** Management may attest that they have complied with all applicable laws and regulations, including tax laws and financial reporting requirements.

**7. Related Parties:** If the company has transactions with related parties, management may disclose these transactions and assert that they have been conducted on an arm's length basis and in accordance with applicable regulations.

**8. Events After the Reporting Period:** Management may disclose any significant events that have occurred after the end of the reporting period but before the financial statements are issued. It's important to note that these attestations represent management's perspective on the financial statements. Auditors, who are independent third parties, conduct their own examination to provide an opinion on whether the financial statements are free from material misstatement. This

independent audit opinion is a critical element of financial statement assurance for stakeholders.

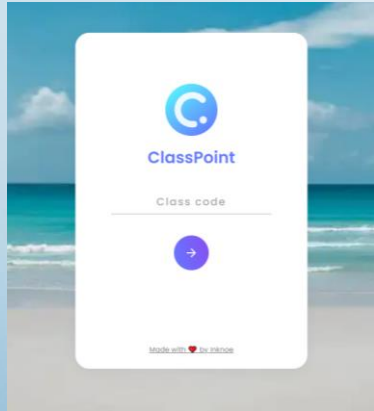


**Control activities** - Policies and procedures must be established and executed to help ensure the actions identified by management to address risk are effectively carried out.



What policies and procedures must cooperatives have?

<https://www.classpoint.app/>





## What policies and procedures must cooperatives have?



1. Membership
2. Loan origination and management
3. Assets and Liability Management
4. Human Resource Management
5. Governance & Board of Directors
6. Compliance and Risk Management
7. Security and Fraud Prevention
8. Member Services and Operations
9. Financial Reporting & Accounting
10. Ethics and Code of Conduct
11. Privacy and Data Protection
12. Disaster Recovery & Business Continuity
13. Training and Education

Credit unions, like other financial institutions, must have a set of policies and procedures in place to ensure their smooth operation, compliance with regulatory requirements, and the protection of members' interests. While the specific policies and procedures may vary depending on the size and complexity of the credit union, here are some basic ones that most credit unions should have:

### **1.Membership and Account Policies:**

- Procedures for accepting and terminating members.
- Guidelines for opening and maintaining different types of accounts (e.g., savings, checking, certificates of deposit).
- Policies regarding joint accounts, beneficiaries, and account access.

### **1.Loan Origination and Management:**

- Guidelines for underwriting loans, including credit risk assessment.
- Procedures for loan application processing, approval, and disbursement.
- Loan servicing procedures, including collections and delinquency management.

### **1.Asset and Liability Management:**

- Policies for managing the credit union's balance sheet, including interest rate risk.
- Investment policies, including acceptable investment types and limits.
- Procedures for liquidity management.

### **1.Governance and Board of Directors:**

- Bylaws governing the credit union's structure and operations.
- Board and committee charters outlining responsibilities and decision-making processes.

- Procedures for board elections and meetings.

**1.Compliance and Risk Management:**

- Procedures for ensuring compliance with relevant financial regulations and laws.
- Anti-money laundering (AML) and Know Your Customer (KYC) policies.
- Risk assessment and mitigation procedures.

**1.Security and Fraud Prevention:**

- Security policies to protect member information and assets.
- Fraud detection and prevention measures.
- Procedures for reporting and handling security incidents.

**1.Member Services and Operations:**

- Policies for providing member services, including online banking, mobile banking, and in-branch services.
- Procedures for handling member inquiries, complaints, and disputes.

**1.Financial Reporting and Accounting:**

- Accounting policies conforming to generally accepted accounting principles (GAAP).
- Procedures for financial reporting, auditing, and internal controls.

**1.Ethics and Code of Conduct:**

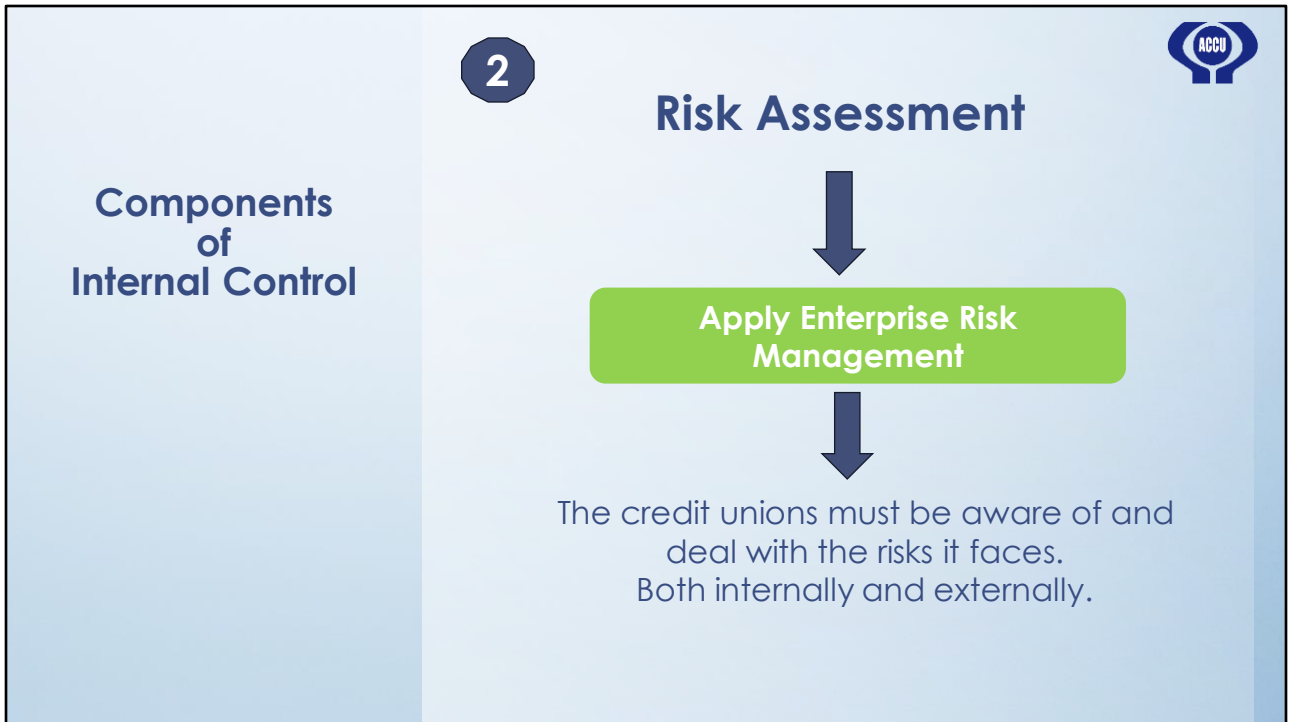
- An ethical code of conduct for employees, volunteers, and board members.
- Procedures for reporting ethical violations and handling ethical dilemmas.

**1.Privacy and Data Protection:**

- Privacy policies outlining how member information is collected, used, and protected.
- Procedures for handling data breaches and notifying affected parties.

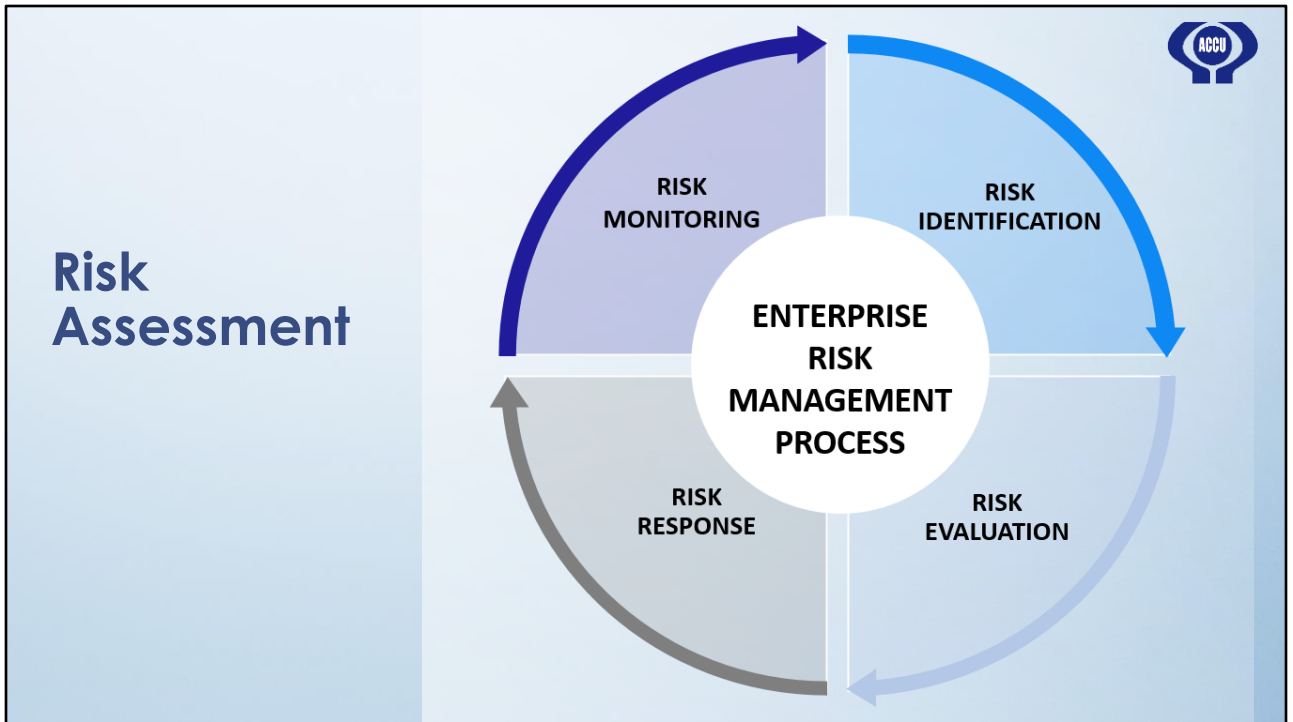
**1.Disaster Recovery and Business Continuity:** Business continuity and disaster recovery plans to ensure the credit union can operate in the event of disruptions.

**2.Training and Education:** Procedures for employee training and education on policies, compliance, and security.



**Risk assessment** - The credit unions must be aware of and deal with the risks it faces. Both internally and externally.

It's important for credit unions to tailor their risk assessment tools and methodologies to their specific operations, size, and risk profile. Regular risk assessments and ongoing monitoring are essential to adapt to changing circumstances and evolving risks. Additionally, credit unions should involve key stakeholders, such as board members, management, and staff, in the risk assessment process to ensure a comprehensive understanding of risks across the organization.



1. Risk identification: Identify main risks that could affect key value drivers and / or threaten the capability to realize strategies and achieve expected goals.

2. Risk evaluation: \*-Assess the severity of identified risks and the level of vulnerability to them, to agree on risk management priorities.

3. Risk response” Define specific action plans for risks on which it is considered appropriate to strengthen risk management system.

4. Risk monitoring: Periodically monitor action plan to ensure proper and timely risk mitigations.



# Credit Union Specific Risk Assessment

## 1. Business Risks

- Strategy
- Market, Credit and Operational Risk
- Financial Risk
- Members

## 2. Control Risks

- Treatment of Members
- Organization
- Internal Systems and Controls
- Board, Management & Staff
- Business & Compliance Culture



It's important to note that the specific risks faced by a credit union can vary based on factors such as its size, geographical location, membership base, and the types of services it offers. Effective risk management practices, including risk assessment, monitoring, and mitigation strategies, are essential for credit unions to navigate these challenges successfully while protecting their members' interests and financial stability.



# Objectives of Managing Risks

	<b>Supervisory Objectives</b>	<b>Risks</b>
1	Promoting Safety and Soundness	Financial Failure
		Poor Cooperative Governance
		Widespread Misconduct and mismanagement
		Financial crime, fraud or dishonesty
2	Ensuring the protection of members' interest	Financial Failure
		Widespread Misconduct and mismanagement
		Financial crime, fraud or dishonesty
		Poor corporate governance
		Inadequate knowledge and understanding of members
3	Reduction of Financial Crimes	Financial crime, fraud or dishonesty

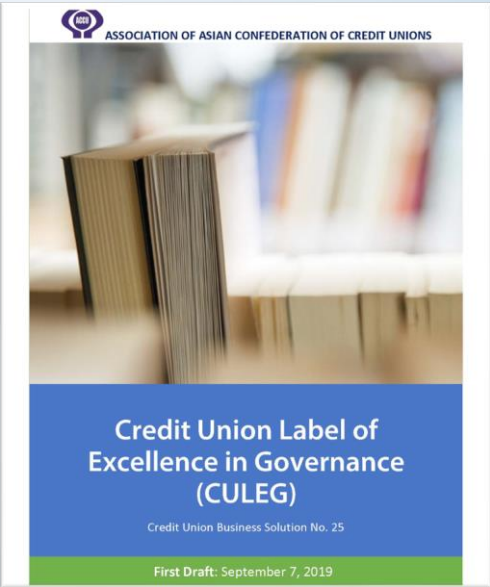


## Risks Assessment Tools

1. PEARLS for SACCOS
2. ACCESS
3. CULEG
4. SWOT Analysis
5. Risk Based Supervision tools
6. Green Coop/Credit Union Assessment Tool



# Business Solution No. 25

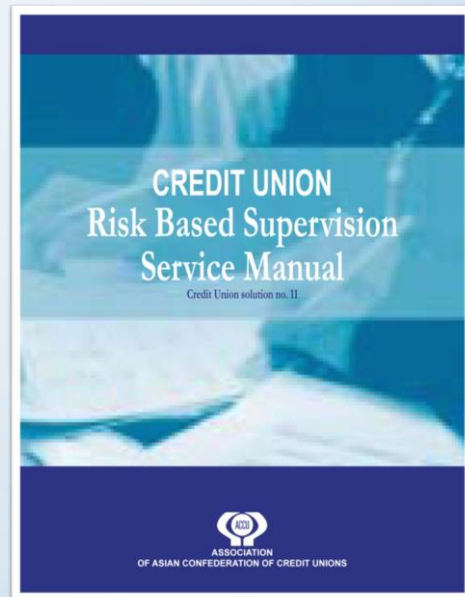


## 11 – Credit Union Risk Based Supervision Manual

**An in-system supervision** to ensure the safety and soundness of credit unions:

**Going beyond** compliance to regulations, standards and sound business practices

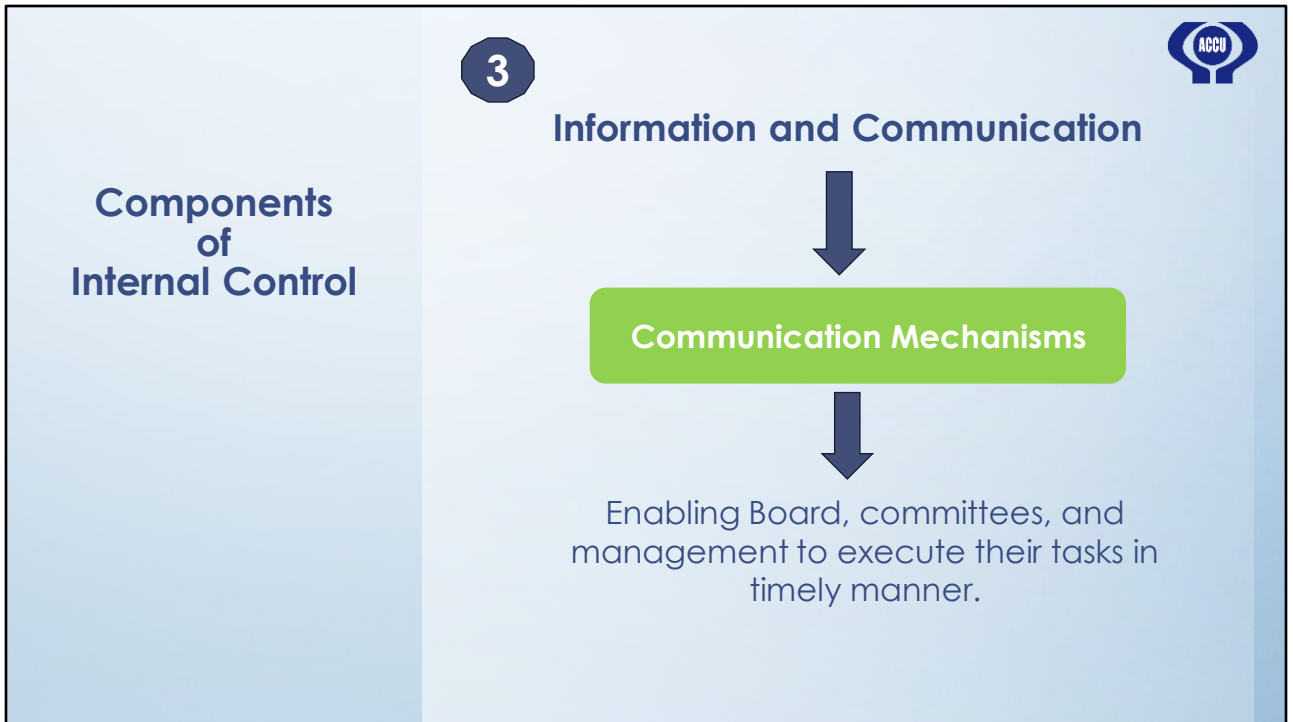
**Identifying** the current and perceived risks of credit unions that may cause systemic risk to the CU system.





## No. 32 – Green Coop/Credit Union Assessment Tool

To recognize cooperatives and credit unions with exemplary achievements in implementing climate action programs.



**Information and Communications** – This is the identification, retention and transfer of information in a timely manner enabling personnel to execute their tasks

information and communication are vital components of an organization's internal control system. Effective communication ensures that control processes are understood and followed, and that information flows appropriately to support decision-making and risk management.



## Information and Communication Tools for internal control

1. Policies and manuals
2. Flowcharts
3. Management reports – monthly
4. Management Letters – memorandums
5. Meetings and Workshops
6. Emails and correspondences
7. Training and Education
8. Whistleblower hotlines
9. Annual reports
10. Members' Ownership meetings
11. Performance appraisal of volunteers and staff
12. Feedback mechanisms

Here are some tools and mechanisms used in internal control for information and communication:

**1.Policies and Procedures Manuals:** Organizations develop written policies and procedures manuals that outline the specific controls and processes in place. These manuals serve as reference guides for employees and provide a documented framework for control activities.

**2.Flowcharts and Process Maps:** Visual representations of processes, such as flowcharts and process maps, help employees and auditors understand the flow of transactions and the control points within various processes.

**3. Management Reports and Dashboards:** Management reports and dashboards provide real-time and periodic information on the status of internal controls and key performance indicators (KPIs). They help management monitor control effectiveness and identify issues that require attention.

**4.Management Letters:** Internal or external auditors may issue management letters or reports detailing control deficiencies, recommendations, and findings. These letters serve as formal communication to management and the board of directors.

**5.Meetings and Workshops:** Regular meetings and workshops can facilitate communication and training on internal controls. These sessions help control owners and employees understand their roles in the control environment.

**6.Email and Correspondence:** Email is commonly used for communication related to control matters, such as sharing updates on control changes, reminders about control activities, and reporting control issues.

**7. Training and Education:** Training programs and educational sessions are conducted to ensure that employees understand their responsibilities with regard to internal controls. Training can help build awareness and competency.

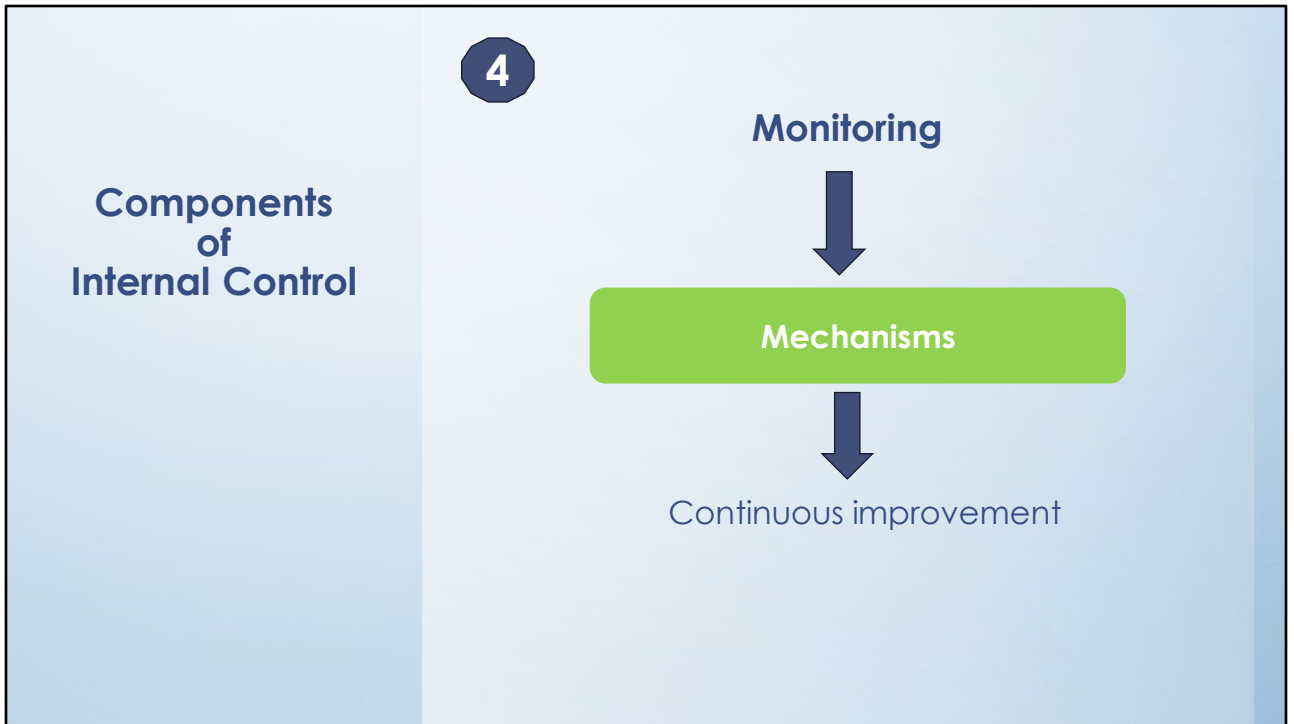
**8. Whistleblower Hotlines:** Whistleblower hotlines or reporting mechanisms allow employees to anonymously report concerns or potential control violations to management or an independent party.

**9. Management's Annual Report on Internal Control (SOX 404):** Publicly traded companies in the United States are required to provide an annual report on the effectiveness of their internal control over financial reporting as per Section 404 of the Sarbanes-Oxley Act.

**10. Feedback Mechanisms:** Organizations establish mechanisms for employees to provide feedback on control processes and suggest improvements.

**11. Performance Appraisals:** Control effectiveness and adherence to control processes may be included in employees' performance appraisals, reinforcing the importance of internal controls.

The choice of tools and mechanisms for information and communication in internal control will depend on the organization's size, industry, complexity, and regulatory requirements. Effective communication of control information helps ensure that control activities are consistently applied, risks are managed, and the organization's objectives are achieved.



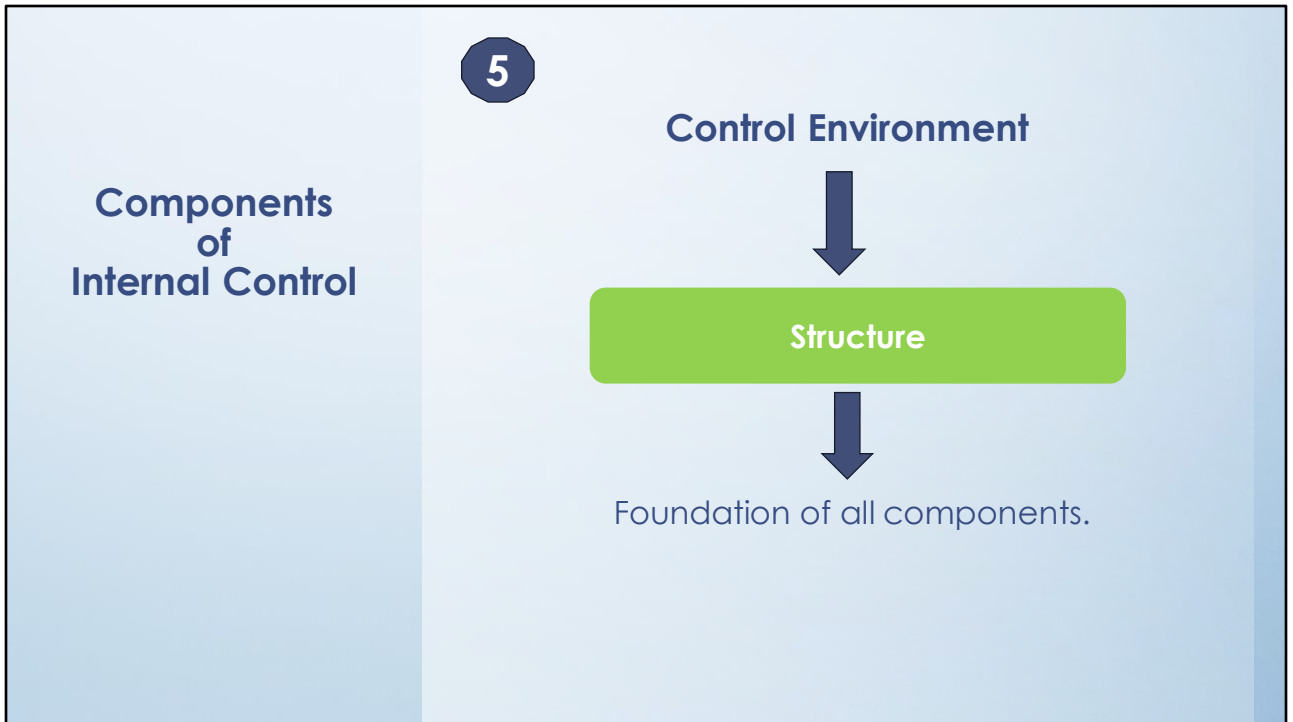
**Monitoring** - The entire control process must be monitored, and modifications made as necessary.



## **Monitoring Mechanisms and Tools**

1. Internal Auditing reports
2. External Auditor's findings
3. Member Satisfaction Surveys
4. Assessment of the Risks from financial ratios  
– what are behind the ratios?
5. Error management

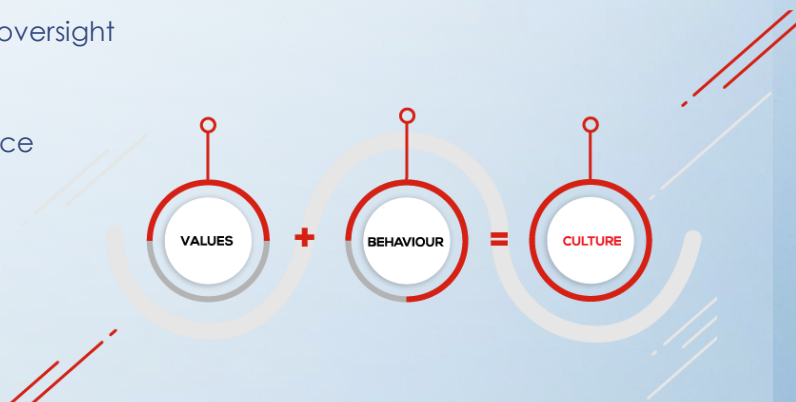




**Control Environment** - The control environment is the foundation for all other components of internal controls and provides discipline and structure.

# Control Environment

- Adherence to cooperative principles and values
- Clear mission, vision, and core values
- Commitment to ethics and integrity
- Board independence and oversight
- Organizational structure
- Commitment to competence
- Accountability

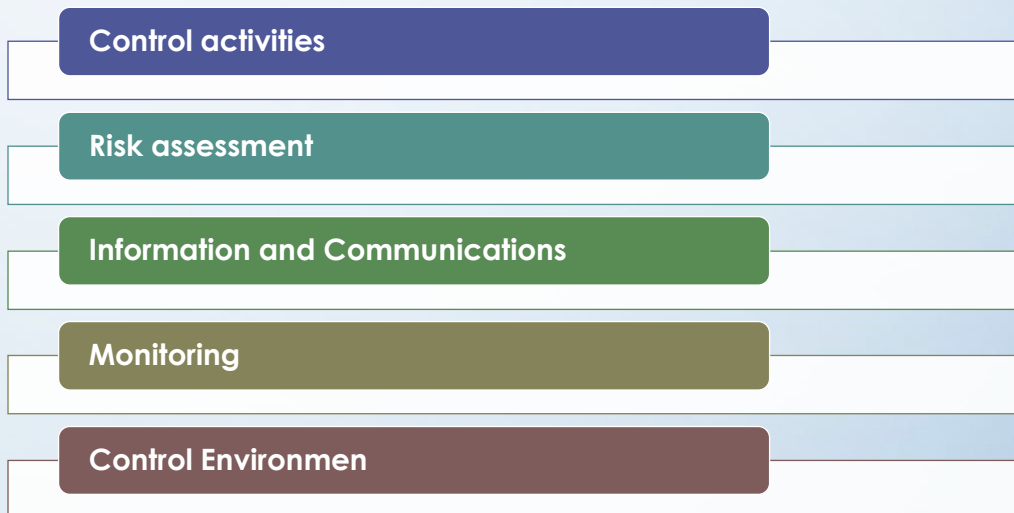


The control environment is one of the five key components of the [internal control framework](#). At a high-level, the control environment basically addresses “tone at the top”. There are 5 key principles in the control environment include:

1. **Commitment to Ethics and Integrity** – A commitment to ethical values and integrity within the company should be easily identifiable. Committing to ethics and integrity is often determined by using the “tone at the top” methodology.
2. **Board Independence and Oversight** – An independent board separate from company’s management that is responsible for oversight. The independent board is responsible for providing objective oversight over the organizations internal control systems.
3. **Organizational Structure** – Organizational structures are used to highlight, determine, assign, and restrict authorities and responsibilities that are necessary within the organization.
4. **Commitment to Competence** – A commitment to bringing in competent employees who are capable of performing the necessary job descriptions. The human resources department will have a general responsibility for hiring capable employees and executives.
5. **Accountability** – The establishment of performance measures such as annual reviews. Employees and executives who work for an organization should be held *accountable* for their actions and wrongdoings.

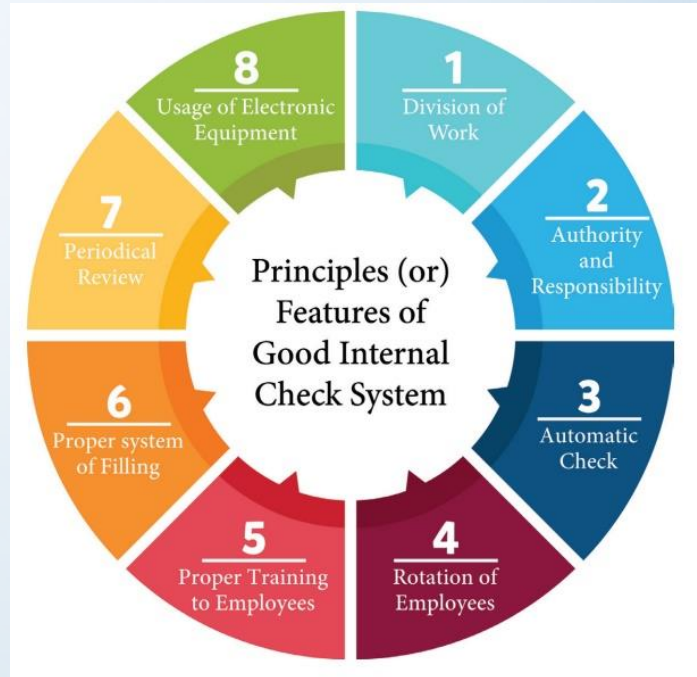


# Components of Internal Control System





**A good system of internal controls include:**



## **Features of Good Internal Control System”**

**1. Division of Work or Segregation of Duties:** Division of work refers to dividing the total work among various staffs in such a way that no single person is allowed to perform the work from the beginning to the end. The work should be allocated to the employee based on the capacity and capability of each person.

**2. Authority and Responsibility:** Authority, duties and responsibilities of each person should be clearly defined and there should not be any overlapping or duplication of duties and responsibilities of any person.

**3. Automatic Check:** Work allocated to the staff should

be in such a way that the work performed by one person is automatically checked by another person.

**4. Rotation of Employees:** A good system of internal check should provide for transfer or rotation of employees from performing one work to another at frequent intervals.

**5. Proper Training to Employees:** An effective system of internal check should carefully select the employees to the organization. The employees should be properly trained, and clear instructions should be given to them to perform their work in an effective and efficient manner.

**6. Proper system of Filing:** Internal check system should provide for proper system of filling vouchers, correspondences etc. in a systematic manner.

**7. Periodical Review:** The system of internal check should at frequent intervals (be reviewed) and suitable changes should be introduced.

**8. Usage of Electronic Equipment:** The system of internal check should provide for usage of labor-saving electronic devices such as calculating machines, personal computers, time recording clocks, book-keeping machines etc. The proper training should als



An effective internal control system is crucial for credit unions to safeguard their assets, maintain financial stability, comply with regulatory requirements, and provide reliable financial services to their members. To establish and maintain such a system, credit unions should consider the following recommendations:

**1. Establish a Strong Control Environment:**

1. Foster a culture of integrity, ethical behavior, and accountability throughout the organization.
2. Clearly communicate the importance of internal controls to all employees, including the board of directors, management, and staff.

**2. Clearly Define Roles and Responsibilities:**

1. Define and document roles and responsibilities related to internal controls, including who is responsible for designing, implementing, and monitoring controls.

2. Assign specific control ownership to individuals or departments.

### **1.Implement Comprehensive Policies and Procedures:**

1. Develop and document policies and procedures that outline control processes, including those related to lending, deposit operations, compliance, and risk management.
2. Ensure that policies are regularly reviewed and updated to reflect changes in regulations and industry best practices.

### **2.Comprehensive Training and Education:**

1. Provide training and ongoing education to employees about the credit union's policies, procedures, and control expectations.
2. Offer specific training on fraud prevention, security awareness, and regulatory compliance.

### **1.Regular Reporting:**

1. Provide regular and transparent reporting on the state of internal controls, control deficiencies, and actions taken to address them to the board and senior management.

### **2.External Benchmarking:**

1. Compare internal control practices with industry benchmarks and best practices to identify areas for improvement and innovation.

By following these recommendations, credit unions can establish and maintain a robust internal control system that enhances financial stability, member trust, and compliance with regulatory requirements. Additionally, it helps mitigate risks and promotes the long-term success of the credit union.





# Supervisory System of Korea Credit Union



How are you, Everybody? My name is Lee, Hee Yong from Korea and I'm the CEO of National Credit Union federation of Korea.

You are the supervisory officers from every Asian countries and It's my great honor to introduce Korean Credit Union's Supervisory System in front of you all. And I hope Korean CUs experience will be helpful to development of your Credit Union Movement

### Financial Institutions under Supervision of the FSC/FSS

Financial Institutions			Number <sup>1</sup>
Banks	Commercial Banks	Nationwide Commercial Banks	8
		Regional Banks	6
		Foreign Bank Branches <sup>2</sup>	40
	Specialized Banks <sup>3</sup>	5	
Non-Bank Financial Institutions	Mutual Savings Banks		110
	Merchant Banking Corporations		2
	Credit-Specialized Financial Companies	Credit Card Companies	6
		Leasing Companies	20
		Installment Finance Companies	15
		New Technology Venture Capital Companies	9
	Credit Unions		976
Insurance Companies	Life Insurance Companies <sup>4</sup>		22
	Non-Life Insurance Companies	Property & Liability Insurance Companies <sup>5</sup>	20
		Reinsurance Companies <sup>6</sup>	6
		Guarantee Insurance Companies	1
Securities-Related Companies	Securities Companies <sup>7</sup>		54
	Asset Management Companies		49
	Investment Advisory Companies <sup>8</sup>		73
	Futures Companies		14

Firstly, let me introduce Korean financial system under FSC or FSS's supervision. In Korea there are total 8 nationwide banks, and 6 local banks and 40 branches of foreign banks.

Also 110 mutual savings banks. And there are totally 920 credit Unions nation wide.

And 22 life insurance company, 20 Non-life insurance company, and 54 securities companies.

Another type of cooperation, there are agricultural cooperation, fishery , forestry and community cooperatives also.

But only Credit unions are fully supervised from government. The other cooperatives has its own governmental administration.

## Structure of Primary CU



Primary Credit Unions has a AGM, it's a prime and basic decision-making organization.

And there is Chair man, the representative of primary Credit union.

Under the chairman, there is GM, general manager. The person who takes charge of usual management of credit union with staffs.

Also there's Board of director and auditors which is compose of board members and there may be some committee for special purpose of performance. It is similar to your countries I think.

# Legal Structure

## EXTERNAL

- **Credit Union Act**
  - Presidential Decree
  - Enforcement Rule
- **Reg. of supervision**
  - Banking Regulations
  - Non-Banking Regulations
  - Accounting Regulations
  - Common Regulations

## INTERNAL

- **NACUFOK**
  - Regulations & Rules
  - Guidelines
- **Credit Union**
  - Compulsory Regulations
  - Optional Regulations

Now I will tell you the structure of law system of Korean credit union. The structure is divided into two categories, internal and external.

In the external system, the Korean Credit Union is ruled and regulated by many general laws. For example, commercial law and financial law, etc.

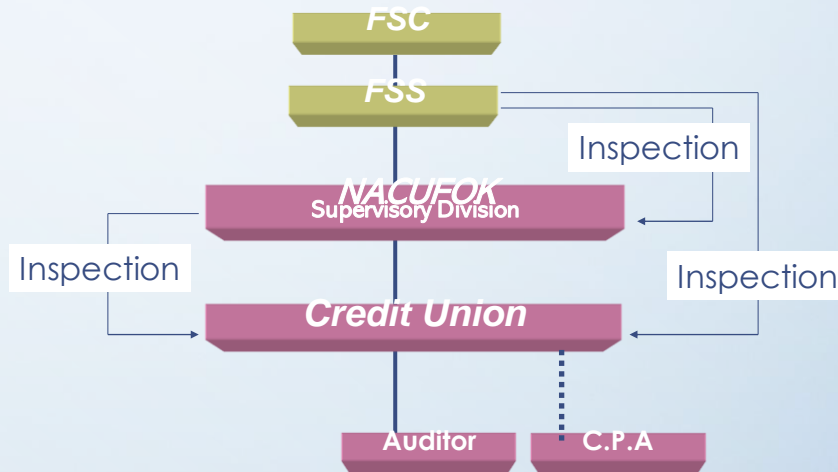
And also we have a special law called Credit Union Law. It is inactivated to promote and extend Credit Union.

Also, FSC/FSS has made many regulations about Credit Union. All Credit Unions have to keep the regulations.

Inside the Credit Union, firstly, national federation makes rules and regulations and guidance.

Primary Credit Union also has made self-made rules and regulations. But usually, federation gives them compulsory regulation for example related with accounting, reporting or preventing financial crime, etc. and optional regulation means they can adopt it or not, it depends on their choice.

## Structure of Supervisory System



FSC : Financial Services Commission (Government)  
FSS : Financial supervisory service (Executive organization)

NOW supervisory system about primary credit union. FSC is governmental organization and FSS is executive organization.

FSC set policy and coordinate the direction of supervision and FSS take charge of real control or supervision.

NACUFOK also supervise the primary Credit Union directly. It means primary Credit union are supervised cross-checked.

Inside the credit union, the auditors check unions operation by themselves and more than certain amount of asset, they have to take external accounting audit by CPA(certified Public Accountants) every year.

Audit committee usually check credit unions policy and management and CPA's accounting audit mainly check accounting system.

## Main Responsibilities

- Deliberation and Resolution of Important Financial Issues
- Guidance and Supervision of the Financial Supervisory Service

## FSC Commissioners

The Financial Services Commission comprises **Chairman, Vice Chairman, Standing Commissioners, and Non-Standing Commissioners.**

The Commission also includes four ex-officio Commissioners:

- the Vice Minister of Strategy and Finance,
- the Deputy Governor of the Bank of Korea,
- the President of the Korea Deposit Insurance Corporation, and the
- Governor of the Financial Services Commission.

The Financial Services Commission has been established for the purpose of protecting the integration of Korea's financial markets by promoting sound credit system and fair business practices. To this end, the FSC serves as a consolidated policy making body for all matters pertaining to supervision of the financial industry as a whole. To raise the efficiency, the posts of the FSC Chairman and the FSS Governor were separated on March 2008 for clear distinction between policy-making and execution of financial market supervision.

The FSC comprises nine commissioners including the Chairman, the Vice Chairman, the Vice Minister of Strategy and Finance, the Deputy Governor of the Bank of Korea, the President of the Korea Deposit Insurance Corporation, the Governor of the Financial Supervisory Service, two members recommended by the Chairman of the FSC, and one recommended by the Chairman of the Korea Chamber of Commerce and Industry. The Chairman, appointed by the President of the Republic of Korea, presides over the FSC meetings and exercises control over general affairs. The resolutions of the FSC meetings are adopted upon the concurrence of a majority of those present. The followings are primary functions of the FSC.

Deliberation and Resolution of Important Financial Issues

Issues concerning the advancement of financial industry, the stability of financial markets, the promotion of a sound credit system and fair trading practices

Guidance and Supervision of the Financial Supervisory Service

Matters pertaining to the guidance and supervision of the FSS such as amendment of the Articles of incorporation and approval of budget and financial statements



## **FINANCIAL SUPERVISORY SERVICE**

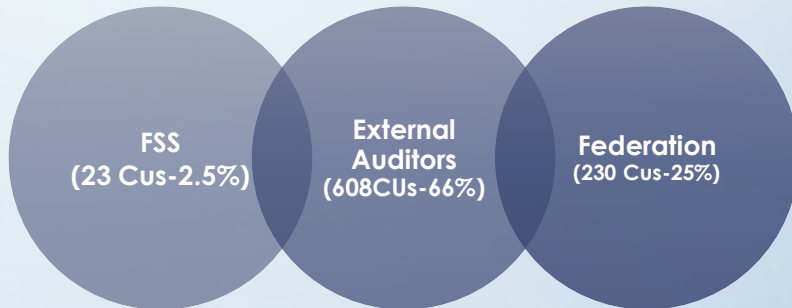
Date of Establishment	January 2, 1999
Act	Establishment of Financial Supervisory Organizations
Four supervisory bodies amalgamated to one	<ul style="list-style-type: none"><li>• Banking Supervisory Authority</li><li>• Securities Supervisory Board,</li><li>• Insurance Supervisory Board, and</li><li>• Non-bank Supervisory Authority</li></ul>
Function	<b>examination and supervision of financial institutions</b> but can extend to other <b>oversight and enforcement functions</b> as charged by the Financial Services Commission

The **Financial Supervisory Service** was established on January 2, 1999, under the Act on the Establishment of Financial Supervisory Organizations by bringing together four supervisory bodies-Banking Supervisory Authority, Securities Supervisory Board, Insurance Supervisory Board, and Non-bank Supervisory Authority-into a single supervisory organization.

**The primary function** of the FSS is examination and supervision of financial institutions but can extend to other oversight and enforcement functions as charged by the Financial Services Commission (the former Financial Supervisory Commission) and the Securities and Futures Commission

# External Regulation

- Totally 578 CUs from 920 inspected by External Inspection, 2014
- FSS/federation : full scope, not overlapped
- External Audit(CPA) : full scope, mainly Accounting.



In case of last year, 23 CU's are inspected from FSS. It is about 2.5% of total CU. And 230 CUs from federation about 25%.

The FSS and federation coordinate there schedule in advance not to be twiced or overlapped.

When a certain CU is examined by FSS federation wipe out its name from the inspection list and add another one.

The List will be confirmed in january, of course FSS never tell their list to federation.

Total 608 CUs are examined by External Accounting audit But it mainly focuses to the accounting it overlapped by FSS or federation.



## NACUFOK's Authority by CU Act (1/2)

1. Demand to submit business report	to examine or inspect soundness in financial structure
2. Administrative disposition (penalty)	<ul style="list-style-type: none"> <li>• <b>Re-election, suspension</b> of performance of duties, or censure, in case of an executive;</li> <li>• <b>Disciplinary dismissal, suspension from office,</b> salary reduction, censure, in case of an employee</li> <li>• <b>Caution or warning,</b> in case of both</li> </ul>

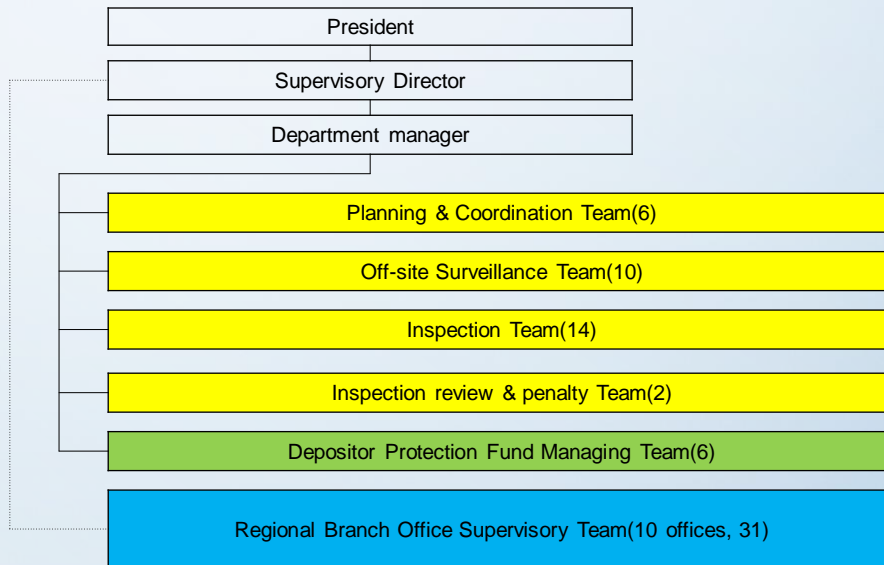
The law authorizes federation do all these job.  
 First, federation demand to submit business report to research or inspect sound management  
 Also, In case of refusal or no response, federation can give them a penalties for example, re-election, suspension of duties, censure on directors.  
 On employees, dismissal. Suspension from office, salary reduction, censure or caution

## NACUFOK's Authority by CU Act (2/2)

3. Inspection for the credit union affairs	Monitoring by the branch offices
4. Administrative disposition (penalty)	<ul style="list-style-type: none"><li>• to merge with another union</li><li>• take a proper measure to improve financial state for example, disposition of assets, downsizing</li></ul>

The law authorizes federation do all these job.  
First, federation demand to submit business report to research or inspect sound management  
Also, In case of refusal or no response, federation can give them a penalties for example, re-election, suspension of duties, censure on directors.  
On employees, dismissal. Suspension from office, salary reduction, censure or caution

## Structure of Supervisory System (national Federation's organization)



Korean CU federation has 12 departments and 400 staffs in total.

In Supervisory department, supervisory directors take charge of whole management. Under the directors there's a department manager and 4 teams and 1 semi-team. Supervisory team, Inspection Team, Off-site Surveillance Team, Fund Managing Team, Inspection review & penalty part. And regional branches we allocate supervisory officer each.

# Planning & Coordination Team

- Planning and Coordination
- Licensing
- Controlling unions received PCA



Supervisory team usually does

1. Planning and Coordinating supervisory policy mainly
2. Collect primary CU's ideas and voice and deliver or communicate with FSS or FSC
3. Approval of Amendment CU bylaws, widening common bond, basic share amount or changing CU names

# Planning & Coordination Team

- **Planning and Coordination**
  - Set up supervisory policy
  - Communicate with FSS or FSC
  - Issue or amend CU by laws
  - Secretarial affairs(personnel, budget)



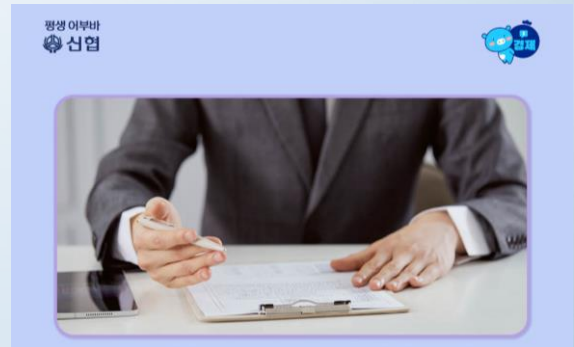
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# Planning & Coordination Team

- **Licensing**

- Conduit services for ; establish, merge, dissolution
- Approval of ; amend articles, open new branch, adjust common bond, subordinated borrowing
- Fit & Proper control; board members



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## Planning & Coordination Team

- **PCA union control**

- ① by Review financial indicators, Evaluate management status
- ② tier; MI Recommendation, MI Requirement, M Control
- ③ apply different improvement measures from each tier action

- **Administrative job/enrollment or release of PCA**

- the regional office performs the action

- **Secretarial duties for the Management Evaluation Committee**

- newly required or recommended & less than 1% unions are subject to
- financial indicators deteriorated

- **Monitoring unions received PCA**

- spot check by regional office : required(semiannually), recommended(annually)
- control with MOU by supervision department : underperformed unions

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# Off-site Surveillance Team

- **Monitoring unusual transactions**
- **Managing unions of priority control**
  - unions with static indicators exceeding predefined level
- **Managing unions of secondary control**
  - unions with indicators varying abnormally



Supervisory team usually does

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# Off-site Surveillance Team

- **Monitoring unusual transactions**

- abnormality,



Supervisory team usually does

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## Off-site Surveillance Team

- **Monitoring unusual transactions**

Monitoring all transaction in CU

- Choose suspicious transaction and  
On-the-spot examination or phone to  
Auditors or President immediately
- Educating To prevent money Laundering
- Inspect for Financial Crime, Moral Hazard (embezzlement...)
- Maintaining Early Warning system  
(analyzing financial data for soundness)

Now Off-site surveillance team.

Computerized monitoring system is built in federation, and federation staff can check all transactions of CU in real time.

During the check, when they find suspicious transaction, team manager dispatch staffs to the primary credit union or call chairman or general manager to verify the transaction or make sure no financial crime.

Another task is to educate or introduce Anti – money laundering system or inspection on financial crime or managing early warning system.

## Off-site Surveillance Team

- Analyze Risk Factor and developing Risk Management System
- Research Financial Crime and moral Hazard
- Publishing case study for financial crime and open and share the experience

Off-site Surveillance team also analyzes risk factor and warn to the primary credit union about bad cash-flow or too much loan and too little deposits, high delinquent rate or money shortage, discordance of maturity structure and so on.

They sometimes publish case book about financial crime in Cu to warn staffs or employees that everybody knows how to make crime.

It is open. Everybody knows about it. Do not try to make a crime.

## Inspection planning team

- Set up inspection policy
- Annual inspection Planning
- Issue inspection order
- Manage travelling inspector(contractual)
- Communicate with FSS or FSC

Inspection team performs mainly on-site inspection about whole business and management of CU. Also inspect or examine complaint or appeal from members and after inspection if it is reasonable, push CU to take right actions. Inspection Team also train or educate member CU's auditors.

## Task of each Team

- **Inspection team**

- Scheduled Regular inspection for Unions' Business affair
- Penalty for Violation or negligence for regulation or Law
- Examine for member complaints
- Educating internal auditor

Inspection team performs mainly on-site inspection about whole business and management of CU. Also inspect or examine complaint or appeal from members and after inspection if it is reasonable, push CU to take right actions. Inspection Team also train or educate member CU's auditors.

## Task of each Team

- **Deposit insurance fund team**
  - Managing Depositor's Protection Fund

Deposit insurance fund Team's main job is how to manage well the depositor's protection fund.

## Depositor's Protection Fund

- Compulsory Joining System
- Funded from CUs for 0.3% per total deposits (Annually).
- FY 2014. approximately 155million dollars from CUs
- Guarantee Members Deposit up to \$ 50,000 in case of CU bankruptcy
- Also using for Subsidies for Merge CU
- Federation claim damage to Boards & employees
- Federation Accuse Boards & employees to the Prosecutor's Office

Depositor's protection fund is the system when primary CU has bankrupted, national federation (exactly protection Fund) guarantee 5 thousand dollars for each member's deposit from the fund. Every CU has to be joined the fund and annually funding rate is 0.3% for its total deposit.

The money is mainly used in case of bankruptcy of primary CU, in case of merger the existing CU will be given federation subsidies upto 90% of total loss for merge compensation.

After financial aids, federation investigate the reason or caused of primary CU's bad loan or loss and then claim damage or accuse board members or employees to the prosecutor's Office.

## Others: **Service for internal Auditor**

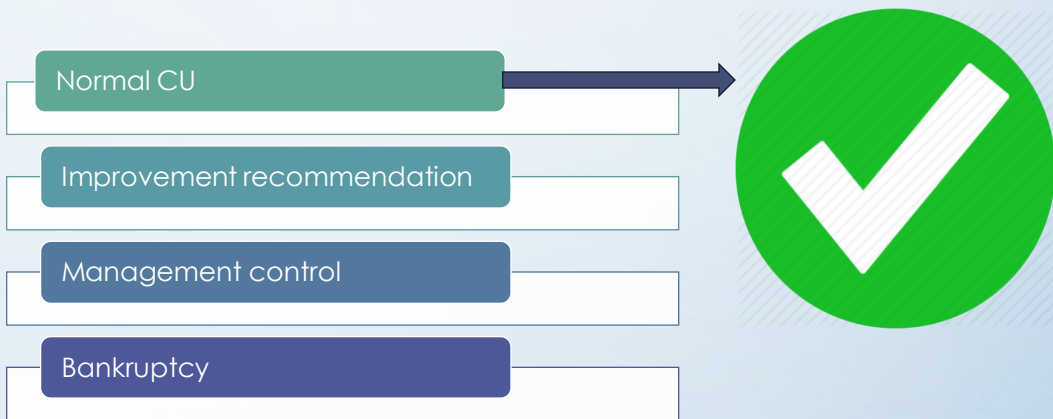
- On the job Training
- Regular Curriculum in Federation's Training Center(a times two years.)
  - compulsory to attend once a 4-year-term
- Regional Branch's regular introduction program annually(1 days)
- Distribute Auditing Manual
- Distribute research report for case study  
for important supervisory issue

Federation also plays a key role in training auditors. Auditors are all volunteers and sometimes they don't have enough knowledge or knowhow or experience on performing self-supervising Cus. So, federation's training center open training program for auditors. Every auditors in Cu should attend regular auditor training program in training center more than 1 time on their 4-year-term.

Also in branch Office, they open 1 or 2 day introduction program every year for busy person. And they distribute auditing manual, research report or case-study papers about important supervisory issues.



## Management Status Analysis & Evaluation



Now I will show you detailed supervisory system for individual Cus

Federation classifies Credit Unions into five categories according to their management status analysis & Evaluation.

Normal, improvement recommendation, improvement requirement, Management control and bankruptcy.

In case of normal Cus, they have full self-control and federation do not interfere their management.

## Management Status Analysis & Evaluation

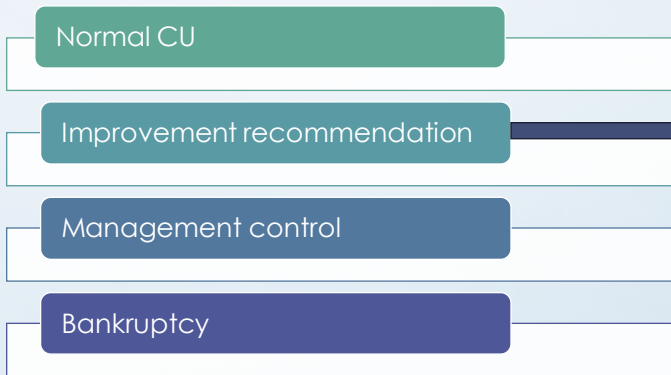


But net capital ratio goes under 2% or total grade is under third grade or Capital Adequacy or Asset Quality is under 4<sup>th</sup> grade.

Net Capital ration is the index for evaluating asset quality, usually it means internal reserves.

For example, 2% means 2% of total asset is reserved and -3% means 3% of total asset is loss.

## Management Status Analysis & Evaluation



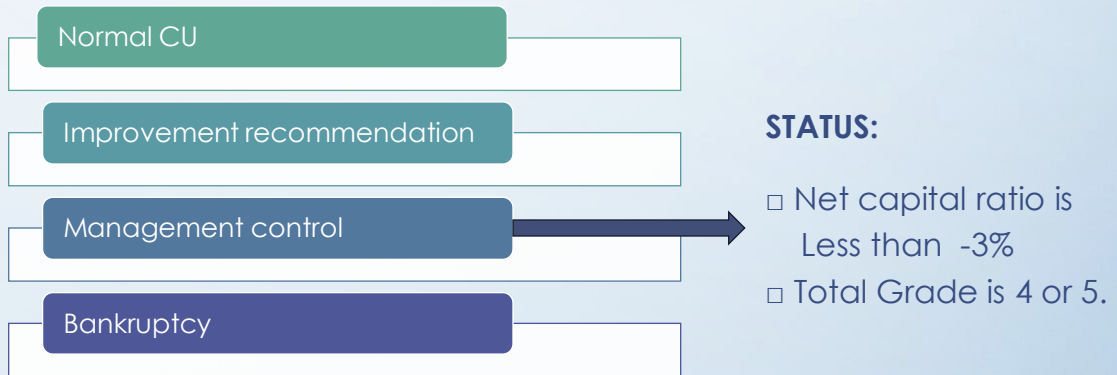
### RECOMMENDATIONS:

1. Improvement in personnel management and organizational operation;
2. Enhancement in the efficiency of business offices especially branch office, Cost reduction;
3. Disposal of risky assets and fixed assets;
4. Increase or decrease in investment;
5. Restriction on distribution of dividends; and
6. Recommendation of merger.

If a CU categorized recommendation group, national federation recommend such measurement.

- (1) Recommend to improve their organization by Downsizing or restructuring. For example, cut down employees.
- (2) Recommend to manage their office efficiently. For example, Save expenses.
- (3) Selling out risky asset and some fixed asset
- (4) Increase or decrease in investment (reduce high risk investment)
- (5) Restrict dividend to improve their financial status.
- (6) Last, Recommend merger

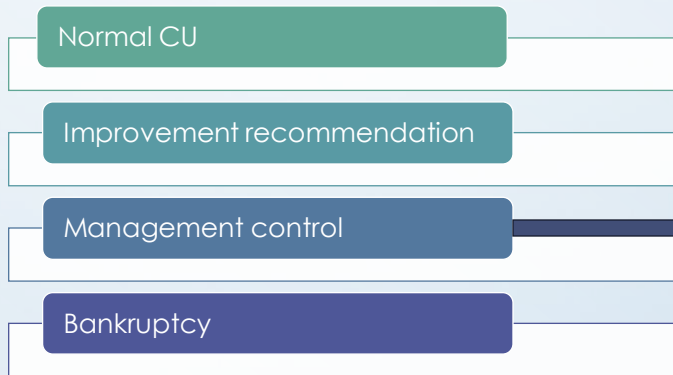
## Management Status Analysis & Evaluation



But net capital ratio is under -3% or total grade under 4<sup>th</sup> or 5<sup>th</sup> grade, we call them improvement requirement Cus.

And federation need them more strong reaction.

## Management Status Analysis & Evaluation



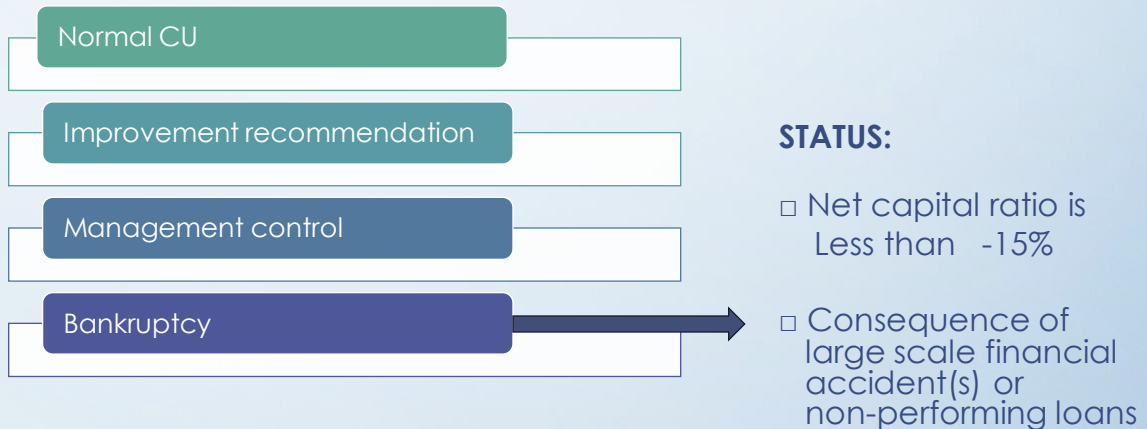
### RECOMMENDATIONS

1. Request for merger;
2. Restriction on holding risky assets and disposal of such assets;
3. Downsizing of organization and manpower;
4. Closure, consolidation or restriction on opening of new branch offices;
5. Restriction on the level of interest applicable To deposits;
6. Request for improvement of executives

Including the recommendation measurement, federation require them

- (1) merger with other CU.
- (2) to Sell off fixed asset or high risk asset, for example their building, vehicles or real estate ....
- (3) Require to improve their organization by Downsizing or restructuring sometime Require to Shut down inefficient branch office
- (4) Restrict interest rate.
- (5) Require suspension of chairman's duties. This is a kind of penalty for delaying improvement.

## Management Status Analysis & Evaluation



In spite of this strong measurement, When The situation goes worse and the net capital ratio is under -15%.

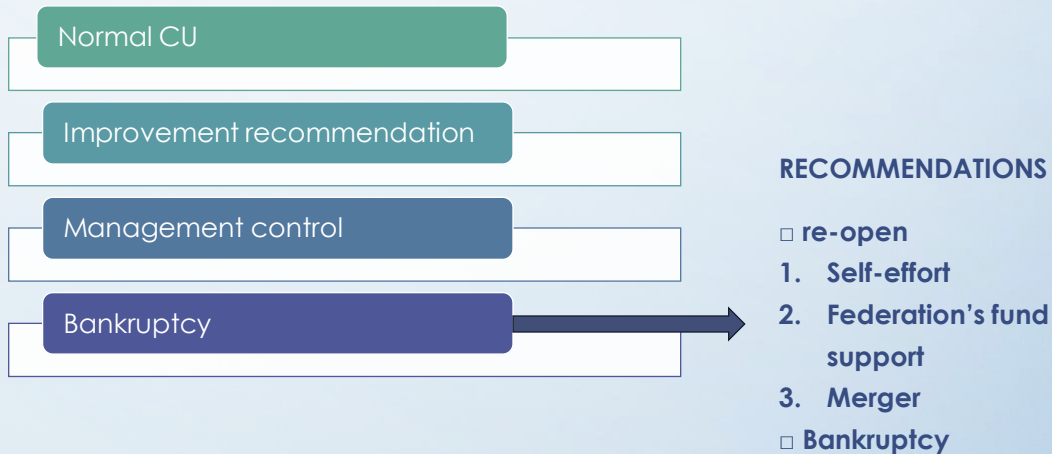
Federation request management control to FSS or FSC.

In recent there is a certain signal that management control ratio will be going upto -7%.

Except the ratio and grade, a Big financial crime or too much delinquency rate can cause management cotroll also.

Basically management control is shut down credit unions management. And after close examination about their financial status, the FSS decide to re-open or go bankrupt.

## Management Status Analysis & Evaluation



The management control suspends up to 6 months, During that period federation evaluate CU's asset closely and exactly.

After examination, total loss will be fixed.

Then CU can choose re-open CU by self-effort or federation's subsidies. For Example contribution from board members or staffs

or funds support from depositor's protection fund.

When re-opening is impossible, federation tries to merge CU into neighboring CU to give member financial service continuously.

In case of merger, federation compensate 90% of loss and the other 10% should be taken by surviving CU to avoid moral hazard.

But most of management controlled Cus go bankruptcy or merger, Because even if they try to

open again, already they lost their trust or credit from the members. SO They can't manage their business again.

If there's no Cu which wants to merge it, insolvent CU will be bankrupt and protection fund will guarantee members money.



**Thank you!!**



Until now, I have introduced Korean Credit union supervising system.

Korean CU becomes world No 3, and Asian No 1 CU with 50 year history.

There is so many financial institutions and high competition in korea.

Between them Korean CU could achieve high development, And all this achievement is thanks to member's active participation and high royalty. Another reason is board member's devoting volunteership.

But some people say federation's strong supervision system could lead Cus into current progress.

I believe Where there is power, Always there is responsibility. Strong power means heavy responsibility for CU's safe and sound development.

I really hope that the your credit unions will be more powerful and dominant, through right segmentation and good relationship among the government administration, the federation and primary credit unions.

I hope our experience and my presentation will be helpful and useful.

Thank you everybody!