



# **BANKING AUDIT:** **A NEW WORLD**



**LOWERS  
& ASSOCIATES**

*International Risk Mitigation Partners*





## Background

The banking industry has undergone significant and historic change since the financial crisis of 2008. The Dodd Frank Wall Street Reform and Consumer Protection Act created heightened expectations and new regulations for financial institutions.

This, in turn, has created the need for additional levels of oversight within the financial institution itself. However, it isn't just financial institutions that are feeling the impact. Third party service providers of financial institutions, including armored carriers, are being impacted as well.

**This paper will look at changes to the regulations that are impacting the armored carrier industry and the financial institutions that work with them.**



# Regulatory Developments

**A**nti-money laundering guidelines have been redefined and additional regulations, driven by the Treasury, have been introduced. The governmental agency responsible for monitoring the financial system is The Financial Crimes Enforcement Network (“FinCEN”).

FinCEN’s mission is to safeguard the financial system from illicit use, combat money laundering, and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities. Financial institutions, as well as the armored car (CIT) industry, are required to abide by FinCEN reporting requirements.

In theory, this adds a layer of accountability to ensure customer accounts have been properly researched and cash deposits are legal. Both banks and CIT carriers have an obligation to report inconsistent deposit activity that doesn’t match with the typical customer deposit profile. As banks outsource to the cash in transit (CIT) industry, they share accountability to record and escalate or face stiff penalties.

**The Office of the Comptroller of the Currency (OCC), has identified significant potential for gaps in risk mitigation and compliance, which has brought more focus on auditing procedures.**

On March 17, 2014, Thomas Curry, Comptroller of the Currency, spoke before the Association of Certified Anti-Money Laundering specialists. His remarks focused on compliance with the Bank Secrecy Act / Anti-Money Laundering Laws (BSA/AML) but his statements were reportedly broadly applicable to other risk management concerns of current interest to the OCC and other federal bank regulatory agencies.



Mr. Curry indicated in his remarks that most underlying BSA/AML infractions can be traced back to the following underlying deficiencies:

- **The organization’s culture of compliance,**
- **The resources committed to compliance,**
- **The strength of the organization’s information technology and monitoring process, and**
- **The quality of risk management.**

Mr. Curry went on to say that these are the qualities that have an impact well beyond BSA/AML compliance and that “go a long way toward explaining how well an institution deals with credit and operations risk.”

You can certainly see how an organization’s “culture of compliance” will impact the quality and reliability of any compliance audit program.

Financial institutions continually look for creative methods for cost reductions and at the same time internal audit programs become more detailed and often without the ability to properly measure results. Audit procedures are generally self-written and based on an implied set of standards drawn on the knowledge and experience of current employees or the hiring of industry experts to obtain an independent survey/review.





## Third Party Outsourcing

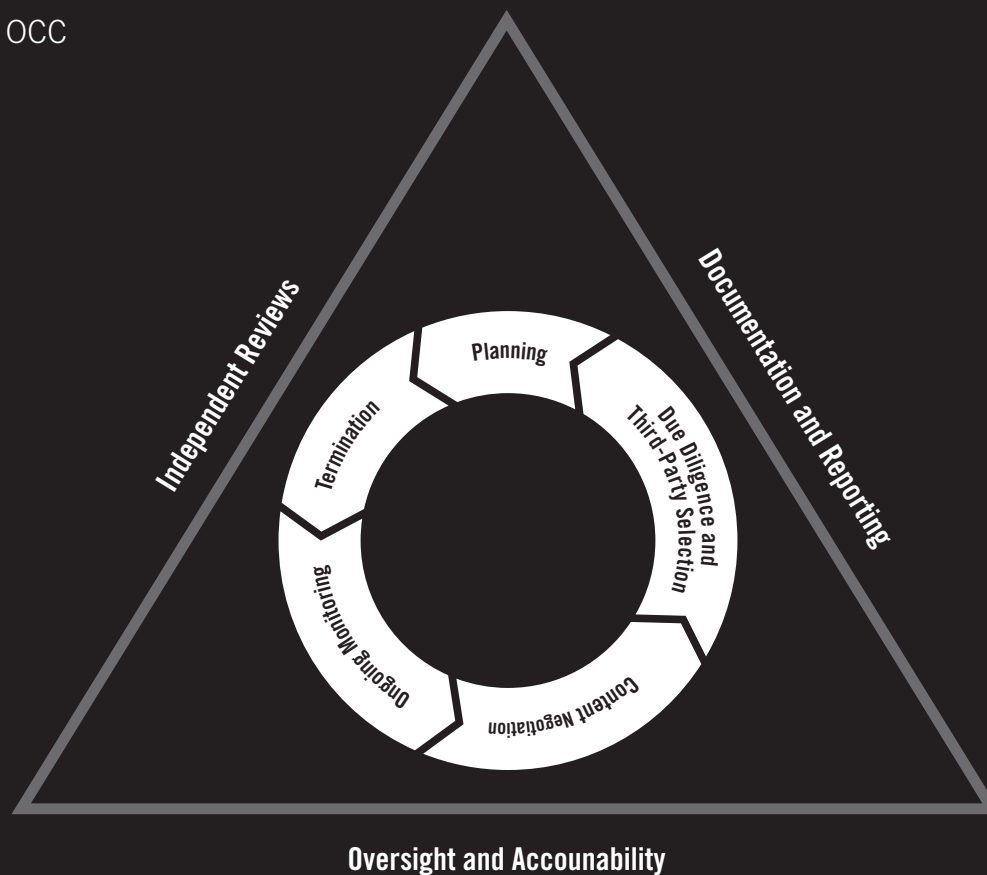
**H**istorically, by outsourcing cash vault operations to CIT companies, financial institutions were able to pass along many of their risks and cost burdens. OCC Risk Management Guidance specific to Third-Party Relationships makes clear that banks are “expected to practice effective risk management whether the bank performs the activity internally or through a third party” and goes on to say that “A bank’s use of third parties does not diminish the responsibility of its board of directors and senior management to ensure that the activity is performed in a safe and sound manner in compliance with applicable laws.”

The OCC expects a bank to have risk management processes that are commensurate with the level of risk and complexity of its third-party relationships and the bank’s organizational structures. Therefore, the OCC expects more comprehensive and rigorous oversight and management of third-party relationships that involve critical activities—significant bank functions (e.g., payments, clearing, settlements, custody) or significant shared services (e.g., information technology), or other activities that:

- **Could cause a bank to face significant risk if the third party fails to meet expectations.**
- **Could have significant customer impacts.**
- **Require significant investment in resources to implement the third-party relationship and manage the risk.**
- **Could have a major impact on bank operations if the bank has to find an alternate third party or if the outsourced activity has to be brought in-house.**

**Clearly there is a responsibility for financial institutions to measure the performance and reporting capabilities of their CIT and other third party service suppliers.**

Source: OCC



Financial institutions have developed strategies for Vendor Management around the OCC's proscribed risk management lifecycle of independent review, documentation and reporting, and finally, oversight and accountability.

These robust Vendor Management programs are designed to ensure risks are being handled appropriately. Banks can sometimes fail in these programs due to lack of understanding of the CIT company procedures and internal controls.

This leads to inherited risks when developing an audit program. For example, the financial institution may or may not decide to implement physical site

assessments or cash and coin counts. When a financial institution performs the audits themselves, there is a propensity to count only their internal cash and coin inventories. This allows the CIT outsourced cash vault personnel to potentially conceal variances and play a shell game to conceal errors/shortages.

Often times, financial institutions recruit talent from other banks and CIT companies. This is a good way to incorporate a new viewpoint and reconstruct best practices. Even so, the industry tends to be factional; some of the processes that are instituted tend to have the same issues of following the path of least resistance for audit controls.

The minimum compliance standards that are utilized have inconsistencies that go undiscovered due to bias, strategy, and cost. The audit controls that are implemented have the same gaps since they are ultimately self-developed and designed around what the bank considers priority. Financial institutions are still left with the risk of inadequate audit capacity.

Many CIT companies and banks utilize a third party to perform site assessments, cash and coin audits, and process best practice reviews.

**The most prevalent concern with an internal review is complacency. This occurs when a CIT cash vault staff becomes acclimated to surroundings and the day-to-day operations, oversight of risks, audits, and best practices.**

A professional third party audit company understands not only the business requirements imposed by financial institutions but also the detailed requirements of the CIT insurers. For example, when banks employ an independent third party for audits of the CIT locations, the inventories can often be counted in whole to validate no shell game is being performed to cover up variances.

Financial institutions can use sound information to properly forecast change orders for commercial customers, ATMs, retail-banking centers, and Federal Reserve deposits.

A professional third party audit company should also incorporate a compliance survey where various inspections of the facility are evaluated. Typical compliance surveys should cover internal controls, hiring, and training documentation, to CCTV coverage. A thorough audit provides a level of assurance to the financial institution that the CIT provider has the capacity and infrastructure to comply with the performance and reporting requirements of the financial institution.

**It is critical that an audit program is developed to incorporate the bank's best interests while validating that minimum compliance standards are in balance.**



# Best Practices

The following are three essential controls and loss prevention methods that would greatly reduce the likelihood, or at least the impact of cash service vendor theft, fraud, or misuse of customer funds:

1

## Annual assessments and periodic cash and coin audits

Financial institutions and insurance policies often require comprehensive, annual risk/compliance assessments of vendor operations and cash/coin external audits by third-party auditors on a regular, quarterly basis. Vendors should be required to submit to such requirements in order to be eligible for work.

2

## Vendor certification

The certification of cash service vendors that prescribes to more rigorous audit and best practice standards would help identify them as low risk business partners enabling their customers and insurers to feel more comfortable and secure.



## Standard audit framework

The creation of a common set of standards, or auditing body, will allow for both comprehensive annual assessments and periodic standardized audits. With all parties employing a similar audit framework, both the assessments and audits performed would be more efficient, comprehensive in scope, and yield standardized results that can then be compared from period-to-period and/or location-to-location. This data could then drive corrective action and overall organizational operational improvement. Furthermore, by requiring regular vendor audits, versus multiple individual audits from each of their customers, audit program cost savings can be realized at the same time loss prevention and control measures are improved.

These are just a few ideas of key best practices. Central in concept is a standard guideline embraced by all parties.

The need for the financial services industry as a whole to embrace and apply universal fundamental cash handling standards is imperative. Financial institutions doing business with the various vendors should have the confidence that these standards are being followed.

**There should be absolute transparency within the vendors so that the financial institution can verify that the appropriate controls are in place and being followed consistently. The ability to conduct a full audit of not only all their own but all customer inventories should be available on demand.**



# CASE STUDY #1: RUNNING SHORT ON STAFF

**I**t was the busy holiday season and there were several key vault employees on vacation leaving operations short staffed. The vault employees were eager to close out the night and decided to count the bank inventories together instead of the required dual blind count. The employees performed the inventory counts and documented the “agreed” value of the currency. They mixed many of the inventories in best efforts to match reporting and by the end of the night there was a shortage that could not be reconciled.

They didn’t realize that there was another employee that was aware of their lack of protocol and he stole cash from one inventory and moved money around to conceal the theft. Instead of following procedures, the vault signed off on the inventories and even left notes for the next shift, which were used to count the morning inventory. This practice went on throughout the holidays until it was finally discovered a week later. After investigation, the process failure and theft were discovered through audit.

The money was never recovered.

# CASE STUDY #2: LOOKS GOOD TO ME

**A** bank had a very detailed procedure to verify that what they had in their system exactly matched what was in their CIT inventory. An internal audit team made appearances at CIT facilities with no notice, hoping to catch the CIT by surprise, thinking this was the best way to validate inventory accuracy.

On one particular visit, the auditors identified themselves to the CIT manager and were told to wait in the lobby area for an escort. Fifteen minutes later, the auditors were escorted to the bank’s inventory and proceeded to do a blind count. The audit procedures required that a percentage of bulk inventory be piece-counted as well.

The auditors called the corporate office to get the official total and the records matched.

The auditors were in and out of the facility in less than an hour, satisfied with the audit results. What the auditors failed to discover was the shell game performed during the time they were waiting in the lobby for an escort. The vault manager quickly pulled up the inventory files and added inventory to match the inventory noted on paper. The bank auditors followed the very well documented process; however, since all inventories were not counted, the shortage was not discovered.



## Conclusion

In recent years there has been a significant increase in government policy reform and regulation to monitor financial institutions. Audit controls associated with cash service providers are paramount as banks are held accountable to more stringent standards to protect banking customers and the bank. This level of oversight, as well as the creation of other government agencies to identify potential anti-money laundering and terrorist funding operations, has created the need for thorough professional audit procedures and controls.

Administering these procedures and controls with only internal resources tends to be more costly and can actually create additional risk. Losses from lack of oversight are common and much more

costly when there are inadequate audit and compliance programs. A qualified third party working within the framework of industry standards or best practices, as well as the requirements of the financial institution, may properly address areas of compliance and audit findings as well as appropriate remediation efforts.

With its extensive knowledge and expertise in the cash handling industry, Lowers & Associates understands how best to employ the current "best practices" standards. Lowers & Associates has programs in place with the leading CIT carriers and insurers alike to both evaluate internal controls compliance, as well as perform full inventory cash and coin audits in any organization on whatever frequency is deemed necessary.





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A Lowers Risk Group company, Lowers & Associates (L&A) is an internationally-recognized independent risk management firm. Armed with extensive industry know-how, L&A is uniquely qualified to provide expert independent cash audit and compliance monitoring services that address the exposures to loss that banks and their CIT and/or ATM partners face on a day-to-day basis. L&A conducts periodic independent audits of cash assets that are in the care and custody of third-party CIT and/or ATM service providers.

**Learn more at [www.lowersrisk.com](http://www.lowersrisk.com)**