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Credit Risk in a Volatile Economy: Lessons from Audit & Compliance

October 28, 2025



Meet Our Presenter

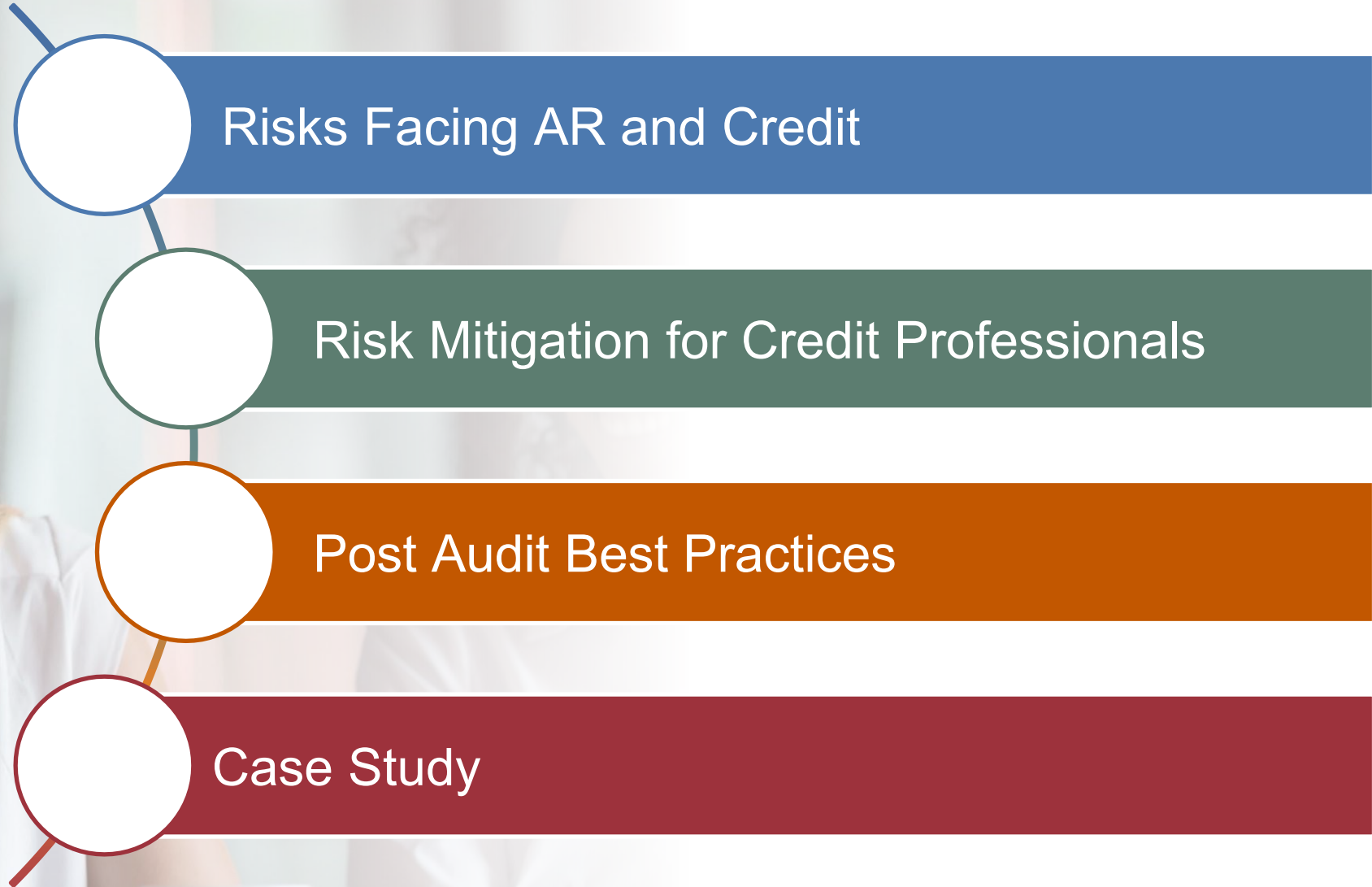
Tim Lietz

MBA, CIA, CRMA

- 15 years with Jefferson Wells
- Former Chief Audit Executive for 2 global firms
- Responsible for Fraud Hotline oversight within organizations and reporting status updates on reported cases to Audit Committees
- Prior Big 4 internal audit leader in Southeast US
- Investigated fraud cases for the past 30+ years across the United States and in Mexico
- IIA Raleigh-Durham Chapter Board of Governors



Overview





Key Risk Indicators (KRIs) for AR and Credit



Key Risks

1 Deteriorating customer payment behavior (rising DSO & aging)

Why this matters now.

Industry data shows **DSO has worsened for a second straight year** and **AR now represents the largest pool of “trapped” working capital** across large U.S. corporates (**≈ \$600B** opportunity), even as overall CCC improvements are being driven mostly by payables—not faster collections.

Key Risks

2 Counterparty deterioration & insolvency risk

Why this matters now.

Global and U.S. business insolvencies **rose sharply in 2024** and are expected to **rise again in 2025** (U.S. forecast **+11%**), driven by still-elevated rates, soft demand and policy uncertainty—directly threatening bad-debt and credit-limit exposures.



A photograph of two men in business attire. On the left, an older man with a white beard and hair, wearing a light blue shirt, a dark vest, and a striped tie, is gesturing with his hands while speaking. On the right, a younger man with dark hair and a beard, wearing a light blue button-down shirt and a dark blazer, is smiling and listening. They are standing in what appears to be an office or meeting room with a whiteboard in the background.

Key Risks

3 Cyber-enabled AR fraud (BEC, vendor banking changes, invoice diversion)

Why this matters now.

Business Email Compromise (BEC) continues to be among the **costliest frauds**: the FBI's 2024 IC3 report logged **\$2.8B** in BEC losses, with nearly **\$8.5B** over **2022–2024**.

Key Risks

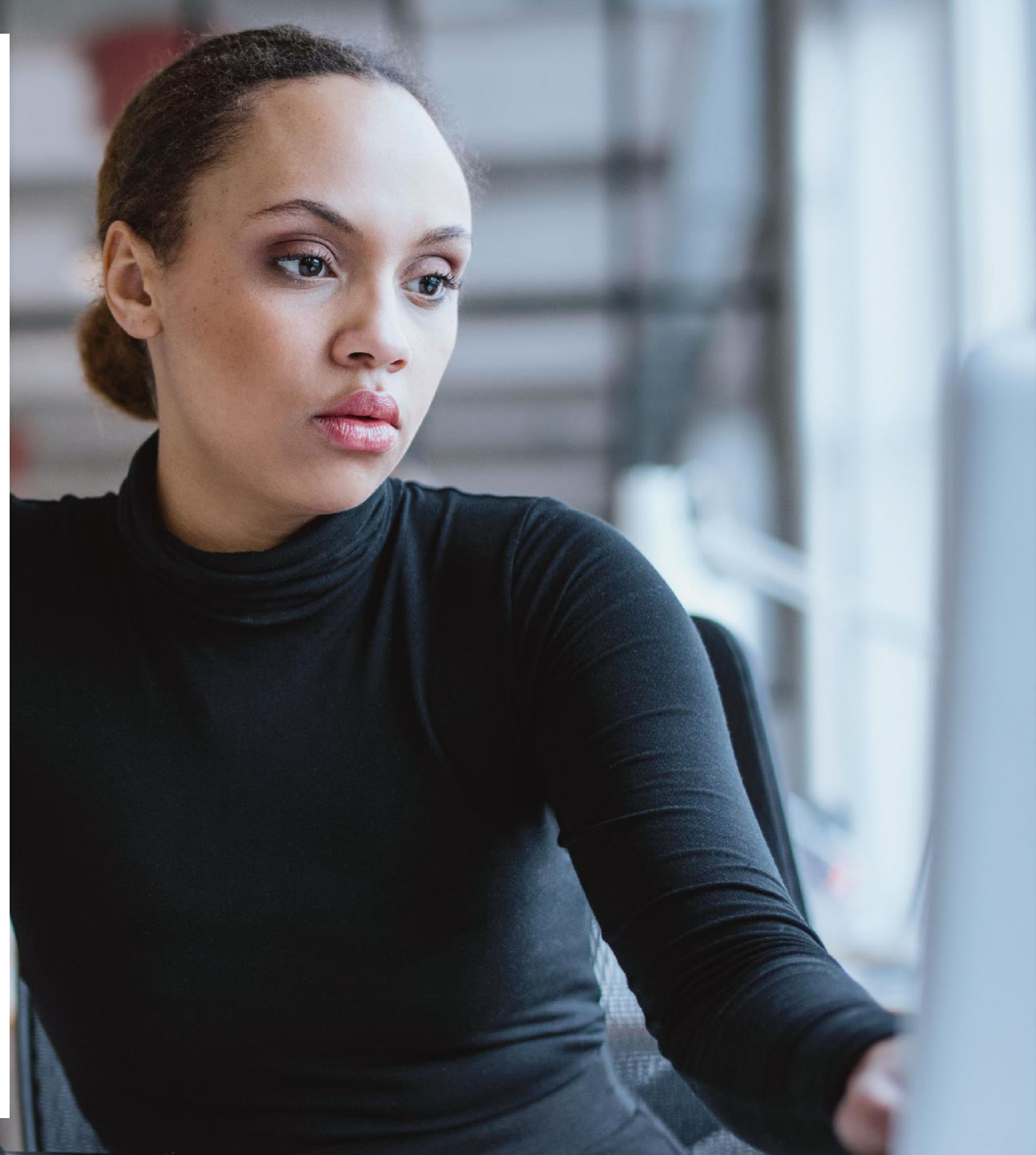
4 Accounting & control pressure (CECL provisioning, ICFR, SoD)

Why this matters now.

Under **ASC 326 (CECL)**, trade receivables require **lifetime expected loss** estimates that incorporate current conditions and reasonable/ supportable forecasts—raising **modeling, documentation, and control** demands for AR/allowance processes.

What's changing in 2025.

FASB issued **ASU 2025-05** to **simplify measuring credit losses for current AR and contract assets** (practical expedient to assume current conditions persist over remaining life; optional policy election for certain entities to consider post-BS-date cash collections), requiring **policy updates** and control changes.



Key Risks

5 Process & data fragmentation across the O2C chain (disputes, leakage, unapplied cash)

Why this matters now.

Even as DPO improvements buoy CCC, **receivables are lagging**, and leaders capture an **18-day DSO advantage** over median peers—an execution gap rooted in **process quality** (billing accuracy, dispute handling) and **data/ERP fragmentation** (cash matching, remittance data).



Leadership Summary of Key KRIs

Liquidity and Cash Conversion

Days Sales Outstanding (DSO) measures cash conversion speed, with top firms collecting 18 days faster than peers.

Collections Effectiveness

Dispute rates, cycle times, and cash application automation track collections efficiency and process health.

Credit Exposure and Risk

Days Sales Outstanding (DSO) measures cash conversion speed, with top firms collecting 18 days faster than peers.

Fraud Controls and Compliance

Bank detail verifications and segregation of duties prevent fraud, while ECL back-test gap ensures accounting accuracy.



KRI's

| Risk Theme | KRI | Why It Matters |
|-----------------------------|-------------------------------------|---|
| Liquidity & Working Capital | DSO (Days Sales Outstanding) | Core measure of cash conversion; median \approx 40–41 days; leaders collect 18 days faster. |
| | % AR > 90 Days | Indicates aging risk and potential bad debt exposure. |
| Credit Exposure | Credit Limit Utilization (Top 50) | Early warning for over-concentration and counterparty stress. |
| | % Customers Over Limit | Signals governance gaps and rising insolvency risk. |
| Collections Effectiveness | Dispute Rate & Cycle Time | High disputes = revenue leakage and delayed cash. |
| | Cash-App Auto-Match % | Low automation = unapplied cash and higher DSO. |
| Fraud & Control | Bank Detail Change OOB Verification | Critical defense against BEC/invoice fraud (FBI: \$2.8B losses in 2024). |
| | SoD Violations in O2C | Prevents fraud and ICFR deficiencies. |
| Accounting & Compliance | ECL Back-Test Gap (bps) | Validates CECL accuracy; large gaps = reserve risk. |



Top Risks to Monitor and Mitigate



Business Continuity Risk Consideration

1 Core billing/ERP & AR
subledger outage (or
corrupt data)

Why this matters.

If your Oracle/PeopleSoft/SAP AR, invoicing engine, or credit/workflow layers go down (or data is corrupted), you can't bill, apply cash, release orders, or see credit exposure.

Materiality is high because AR is the largest pool of "trapped" working capital across large U.S. corporates.

Business Continuity Risk Consideration

2 Third-party/SaaS dependency failures (lockbox, EDI/portals, dispute, collections, scoring, BPO)

Why this matters.

Cash-app, e-remittance capture, dispute resolution, and collections often sit on **external rails** (lockbox banks, portals, HighRadius/collector tools, BPO centers). One outage stalls cash application and elongates DSO.



The background features a dark blue field with glowing binary code (0s and 1s) scattered throughout. A grid of light blue squares is visible in the upper right quadrant. In the lower left, there is a stylized bar chart with orange outlines and semi-transparent bars. A bright light source is positioned in the center-left, casting a glow over the grid and binary code.

Business Continuity Risk Consideration

3 Cyber incidents that interrupt
billing & collections
(ransomware, BEC-driven
diversion)

Why this matters.

Ransomware halts operations;
Business Email Compromise
reroutes funds and forces payment
holds while you investigate—both
choke cash conversion. FBI IC3
reported **\$2.8B in BEC losses in
2024** alone.

Business Continuity Risk Consideration

4 ICFR breakdown during contingencies (SoD overrides and manual workarounds)

Why this matters.

Under pressure, teams bypass controls to “keep cash flowing,” creating risk of misstatement, fraud, and audit findings.





Business Continuity Risk Consideration

5 Credit decisioning blind spots
(loss of scores, bureau feeds,
insurer downgrades)

Why this matters.

If risk feeds (D&B/insurer/ratings) or internal scoring engines are down, limits/terms are set blindly, increasing bad-debt probability during stress.

Fraud Control Risk

1 Business Email Compromise (BEC) & Payment Diversion

Why this matters.

FBI IC3 reports show BEC remains one of the costliest fraud types, with **\$2.8B in losses in 2024**. Fraudsters target AR teams with fake bank detail change requests or invoice redirection schemes.





Fraud Control Risk

2 Segregation of Duties (SoD) Conflicts

Why this matters.

Combining roles like **customer master maintenance, invoicing, and cash application** creates opportunities for internal fraud and ICFR deficiencies.

Fraud Control Risk

3 Lapping, Skimming & Misappropriation of Payments

Why this matters.

Classic AR fraud schemes—such as lapping (using new receipts to cover stolen funds) and skimming—still occur, especially in high-volume environments.





Fraud Control Risk

4 Fictitious Credits, Unauthorized Write-offs & Deductions Abuse

Why this matters.

Fraudulent credit memos or inflated deductions can mask theft or manipulate revenue.

Fraud Control Risk

5 Cyber-Enabled AR Fraud & Synthetic Identity Risk

Why this matters.

Fraudsters exploit **digital invoicing platforms** and **real-time payments** to execute account takeovers and synthetic identity schemes.



Third Party Risk Consideration

1 Lockbox & Bank Processing Disruptions

Why this matters.

Lockbox services and bank file transmissions are critical for cash application. Outages or delays can stall posting, inflate unapplied cash, and distort credit exposure.





Third Party Risk Consideration

2 SaaS Platform Downtime (Collections, Dispute, Credit Scoring Tools)

Why this matters.

Many AR functions rely on third-party SaaS for collections workflows, dispute resolution, and credit risk scoring. Downtime disrupts contact strategies and decisioning.

Third Party Risk Consideration

3 Data Security & Privacy Breaches at Vendors

Why this matters.

AR vendors handle sensitive customer and payment data. A breach can lead to regulatory penalties and reputational damage.





Third Party Risk Consideration

4 Third-Party Fraud Exposure (BEC & Payment Diversion)

Why this matters.

Fraudsters often exploit vendor relationships to inject fraudulent payment instructions or compromise email threads.

Third Party Risk Consideration

5 Vendor Financial Health & Continuity Risk

Why this matters.

Insolvency or operational failure of a critical AR vendor (lockbox provider, BPO, SaaS) can halt cash flow processes.





Integrating Audit Findings into Credit Decisioning

Integrate Audit Findings Into Credit Decisioning

1. Map Audit Findings to Credit Risk Framework

Classify findings by risk type:

- *Policy gaps* (e.g., missing credit reviews)
- *Control weaknesses* (e.g., SoD violations, unverified bank changes)
- *Process inefficiencies* (e.g., dispute resolution delays)

Align each finding to your **credit risk appetite** and **KRI/KPI structure** (e.g., DSO, % AR > 90 days, SoD breaches).



Integrate Audit Findings Into Credit Decisioning

2. Embed Findings into Credit Decision Rules

Credit Limit Adjustments:

If audit flags weak limit governance or overdue reviews, **tighten auto-approval thresholds** and require manual escalation for high-risk accounts.

Terms & Exposure:

Findings on policy non-compliance → enforce stricter **terms exception controls** and **limit overrides**.

Fraud Controls:

If audit notes gaps in bank detail verification or SoD, **block credit releases** until remediation is confirmed.



Integrate Audit Findings Into Credit Decisioning

3. Update Risk Scoring Models

Incorporate **control health indicators** (e.g., SoD compliance, timely credit reviews) as **qualitative risk factors** in credit scoring.

Weight these factors in **credit decision engines** so accounts tied to weak controls or flagged processes carry higher risk scores.



Integrate Audit Findings Into Credit Decisioning

4. Strengthen Governance & Monitoring

Action Plans: Link each audit finding to a remediation owner and timeline; track in Credit Committee dashboards.

KRIs: Add control-related KRIs (e.g., % overdue credit reviews, SoD violations) to your monthly risk pack.

Heat Map: Show combined operational + control risk for leadership (e.g., Red = high exposure + weak controls).



Integrate Audit Findings Into Credit Decisioning

5. Close the Loop with Internal Audit

Quarterly syncs with Audit to review remediation progress and emerging risks.

Use audit insights to **stress-test credit policies** and **simulate impact** on bad debt and working capital.





Case Study – Oakwood Homes Late 90's

Oakwood Overview

- Manufactured Housing Industry
- Industry Filled with Ethics Challenges
- Very Confident Senior Leadership Team
- Spent Capital Freely – 3 Corporate Jets
- Vertically Integrated Company
 - Manufacturing Facilities Across USA
 - Hundreds of Sales Centers
 - Finance Division – Packaged Deals into REMICs and sold to Wall Street



Oakwood Homes

Began accepting substandard applicants – credit quality dropped Mortgage pools packaged as a REMIC sold to Wall Street -- did not perform as advertised

Results:

- Oakwood went bankrupt
- Bought out of receivership by Clayton Homes

Lessons Learned:

- Overconfident Management Team
- Credit Standards
- Internal Controls



Oakwood Homes

Key Lessons for Credit Risk Professionals

Overreliance on securitization without robust credit quality controls magnifies systemic risk.

Market concentration in cyclical sectors (like manufactured housing) requires dynamic stress testing.

Governance and fraud prevention remain critical during rapid growth phases.

Questions?



Thank you for attending!

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Risk & Compliance

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