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FRB FEDERAL CREDIT UNION

APR 17 '06 PM12:57 BOARD

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April 12, 2006

Ms. Mary Rupp – Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Part 715 ANPR, Supervisory Committee Audits

Dear Ms. Rupp:

Thank you for the opportunity to comment on the Advanced Notice of Proposed Rulemaking (ANPR) on Supervisory Committee audit rules dated February 23, 2006. The FRB Federal Credit Union is a natural person credit union with $36 million in assets and 3,275 members. The FRB Federal Credit Union provides the following comments labeled by question number contained in the ANPR.

Comment

1. Should part 715 require, in addition to a financial statement audit, an "attestation on internal controls" over financial reporting above a certain minimum asset size threshold? Explain why or why not.

It seems that an "attestation over internal controls" requirement should only be mandated if there has been a demonstrated need for such a requirement, and not just for the sake of parity between insured financial institutions. The Sarbanes-Oxley Act imposes requirements on public companies, the vast majority of which are not subject to the degree of regulation and supervision that insured depository institutions face. While Sarbanes-Oxley may be deemed to be necessary for the protection of investors, the regulatory scheme for financial institutions focuses on protection of depositors and uses many tools to accomplish that purpose that are not available to the Securities and Exchange Commission for the protection of investors. If the size and complexity of an insured depository institution warrants attestation of internal controls as an additional safeguard, imposition of such a requirement appears warranted.

FRB Federal Credit Union
P.O. Box 9867
Washington, DC 200016
Telephone (202) 452 – 3871 Fax (202) 833 - 2142

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Generally, the risk factors between credit unions and banks are different with credit unions being inherently less risky. However, that difference might be substantially less clear at higher deposits levels, since larger organizations are inherently more complex ***than*** smaller ones. If NCUA concluded that the complexity and risk of a credit union with $1 billion in assets closely matched that of an insured bank of the same size, it would be appropriate to use the same asset size as the point for requiring attestation of controls. If, however, the NCUA determined that the level of complexity and risk of an insured bank with assets of $1 billion was not likely to be reached until the credit union had assets in excess of $2 billion or more, NCUA should use the higher asset standard.

2. What minimum asset size threshold would be appropriate for requiring, in addition to a financial statement audit, an "attestation on internal controls" over financial reporting, given the additional burden on management and its external auditor? Explain the reasons for the threshold you favor.

If an attestation was required, the threshold should be no lower than that used by the FDIC, which is established at $1 billion in assets. As noted above, insured depository institutions operate under safeguards that do not exist for most public companies and the requirement to attest to the effectiveness of controls should meet a regulatory need. As noted in the answer to question 1, if an attestation requirement is imposed on credit unions, the minimum asset size at which the requirement should be imposed is $1 billion. Larger organizations would seem to be more capable, in terms of resources, to implement the attestation requirement, and larger organizations generally may be more complex than smaller organizations and therefore may require the additional control.

3. Should the minimum asset size threshold for requiring an "attestation on internal controls" over financial reporting be the same for natural person credit unions and corporate credit unions? Explain why.

To the extent that a difference exists between natural person credit unions and corporate credit unions, the latter are more bank-like than the former. As noted in the response to question 1, if the NCUA determines that the level of complexity and risk of a credit union with $1 billion in assets matches that of a bank with $1 billion in assets, the standard should be the same for credit unions and banks. If, however, the NCUA concludes that the complexity and risk associated with a bank with $1 billion in assets is unlikely to be reached by a credit union until its assets reach a higher level, the NCUA should set the higher level as the minimum size threshold. If the NCUA concludes that corporate credit unions are sufficiently similar to banks to warrant imposing the threshold applicable to banks, it should do so even if the result is that the threshold is different for natural person credit unions.

FRB Federal Credit Union
P.O. Box 9867
Washington, DC 200016
Telephone (202) 452 – 3871 Fax (202) 833 - 2142

4. Should management's assessments of the effectiveness of internal controls and the attestation by its external auditor cover all financial reporting, (i.e., financial statements prepared in accordance with GAAP and those prepared for regulatory reporting purposes), or should it be more narrowly framed to cover only certain types of financial reporting? If so, which types?

Credit unions are private, not-for-profit organizations and do not sell shares that are subject to fluctuation on the basis of publicly available information. Any covered reporting should be limited to regulatory reporting purposes.

5. Should the same auditor be permitted to perform both the financial statement audit and the "attestation on internal controls" over financial reporting, or should a credit union be allowed to engage one auditor to perform the financial statement audit and another to perform the "attestation on internal controls?" Explain the reasons for your answer.

Credits unions should be allowed to engage two different auditors (one for the financial statement audit and one for the attestation); however, credit unions should not be required to engage two different auditors. Indeed, the cost for engaging two different auditors would most likely be excessively high. In addition, audits of the financial statements require some testing of the key internal controls in order to determine if such controls can be relied upon in the production of the financial statements and for delivering the audit opinion. The auditor performing the financial statement audit would be in the more efficient position to perform the attestation requirement. Therefore, a requirement that the credit union engage two different auditors is likely to be more expensive and less efficient for implementation of a control that is less meaningful for a regulated and supervised credit union than it would be for a public company. Considering the limited purpose of the control and the heightened awareness of auditors of their responsibilities in this area, use of the same auditor for financial statement audit and attestation is probably sufficient.

6. If an "attestation on internal controls" were required of credit unions, should it be required annually or less frequently? Why?

Less frequent attestations should be sufficient given the lower risk environment in which most credit unions operate, and would help contain attendant costs of such a requirement. Should an attestation be required (after the initial attestation) subsequent attestations should only be mandated when controls have been changed (or at some longer interval other than annually).

7. If an "attestation on internal controls" were required of credit unions, when should the requirement become effective (i.e., in the fiscal period beginning after December 15 of what year)?

At least two years after the publication of the final rule. For example, if a rule was published in 2007, the requirement should become effective for year-end 2009 reporting. This would give credit unions adequate time to prepare and implement a program for attestation (control assessment, documentation, testing).

8. If credit unions were required to obtain an "attestation on internal controls," should part 715 require that those attestations, whether for a natural person or corporate credit union, adhere to the PCAOB's AS 2 standard that applies to public companies, or to the AICPA's revised AT 501 standard that applies to non-public companies? Please explain your preference.

Since credit unions are private and investor protection is not the purpose of the attestation, the AICPA's revised AT 501 standard should be adequate.

9. Should NCUA mandate COSO's *Internal Control – Integrated Framework* as the standard all credit union management must follow when establishing, maintaining and assessing the effectiveness of the internal control structure and procedures, or should each credit union have the option to choose its own standard?

Yes. The COSO's Internal Control – Integrated Framework should be the standard set forth to be followed by credit unions. A uniform benchmark is preferable.

10. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have a minimum level of experience or expertise in credit union, banking or other financial matters? If so, what criteria should they be required to meet and what should the minimum asset size threshold be?

Given that committee members are volunteers and credit union members, there should not be special expertise required. The Sarbanes-Oxley Act's focus on financial experts as members of the board of directors is appropriate for public companies that are not supervised and not subject to examination because those companies do not have significant outside controls. Since credit unions are subject to examination and extensive regulation and do not have shares that fluctuate in price, the needs addressed by Sarbanes-Oxley are not present. However, the NCUA may want to encourage that at least some members of the committee should receive training or have a background in banking, accounting or auditing.

FRB Federal Credit Union
P.O. Box 9867
Washington, DC 200016
Telephone (202) 452 – 3871 Fax (202) 833 - 2142

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11. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have access to their own outside counsel? If so, at what minimum asset size threshold?

No. Individual Supervisory Committee members should not be required to have access to their own counsel. Requiring that supervisory committee members be given access to their own outside counsel creates too much risk that a particular supervisory committee member might require counsel at great expense to the credit union, for no real benefit.

However, the Supervisory Committee should have the right to request and be granted reasonable legal fees appropriate to asset size and operational complexity. Given that the committee is comprised of volunteers whose financial sophistication may vary greatly from credit union to credit union, access to an outside counsel with expertise in credit union regulatory matters may be helpful to the supervisory committee. In any event, such access should not be required for small credit unions that are not complicated because the expense may be substantial and exceed benefits derived. A determination about the appropriateness of permitting such access should be made on a case by case basis and may be most appropriately used in connection with the examination process. Clear weaknesses and deficiencies in the supervision of the credit union might cause the NCUA to recommend that the supervisory committee access outside counsel to strengthen the supervisory committee's ability to ensure that appropriate corrective actions are taken.

12. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be prohibited from being associated with any large customer of the credit union other than its sponsor? If so, at what minimum asset size threshold?

No. The concept of 'customer' is realistic in banking, but less so in credit unions. We lend to our members and while a business might be a member, the chances of that business having a significant amount of loans with a credit union are not great and any conflict of interest would be between the customer and the lending officer(s) of the credit union and its Board of Directors, but not its Supervisory Committee. Finally, the credit union's rules regarding conflicts of interest and NCUA regulations on the same subject should address most of these concerns without the need for the suggested prohibition.

FRB Federal Credit Union
P.O. Box 9867
Washington, DC 200016
Telephone (202) 452 – 3871 Fax (202) ...

13. If any of the qualifications addressed in questions 10, 11 and 12 above were required of Supervisory Committee members, would credit unions have difficulty in recruiting and retaining competent individuals to serve in sufficient numbers? If so, describe the obstacles associated with each qualification.

Yes. The pool of volunteers would be limited if any of the requirements specified in 10-12 above were implemented. Such requirements would be more appropriate if committee members were compensated for their services.

14. Should a State-licensed, compensated auditor who performs a financial statement audit and/or "internal control attestation" be required to meet just the AICPA's "independence" standards, or should they be required to also meet SEC's "independence" requirements and interpretations? If not both, why not?

Given that credit unions are private, the AICPA's standard of independence is adequate.

15. Is there value in retaining the "balance sheet audit" in existing §715.7(a) as an audit option for credit unions with less than $500 million in assets?

Yes. The option of retaining the balance sheet audit is desirable, and may meet the compliance needs of certain credit unions.

16. Is there value in retaining the "*Supervisory Committee Guide* audit" in existing §715.7(c) as an audit option for credit unions with less than $500 million in assets?

Yes. Allowing more options (than less) is desirable given the nature of credit union operations.

17. Should part 715 require credit unions that obtain a financial statement audit and/or an "attestation on internal controls" (whether as required or voluntarily) to forward a copy of the auditor's report to NCUA? If so, how soon after the audit period-end? If not, why not?

No. Present NCUA examination procedures include a review of the Supervisory Committee's audit and other work papers. Credit unions receiving closer supervisory scrutiny are in close contact with NCUA field staff already and they receive all credit union reports they deem necessary.

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18. Should part 715 require credit unions to provide NCUA with a copy of any management letter, qualification, or other report issued by its external auditor in connection with services provided to the credit union? If so, how soon after the credit union receives it? If not, why not?

See answer to 17 above.

19. If credit unions were required to forward external auditors' reports to NCUA, should part 715 require the auditor to review those reports with the Supervisory Committee before forwarding them to NCUA?

Yes. The Supervisory Committee should have the opportunity to review the reports with the auditors before the reports are submitted.

20. Existing part 715 requires a credit union's engagement letter to prescribe a target date of 120 days after the audit period-end for delivery of the audit report. Should this period be extended or shortened? What sanctions should be imposed against a credit union that fails to include the target delivery date within its engagement letter?

A 120-day period seems reasonable, but a longer target reporting date (such as 180 days) may significantly reduce audit fees for credit unions scheduling year end audits. Sanctions should be imposed only in cases of repeated (chronic) negligence in including a target date in the management letter. Examiners should reflect such omissions in its appraisal of management during the exam.

21. Should part 715 require credit unions to notify NCUA in writing when they enter into an engagement with an auditor, and/or when an engagement ceases by reason of the auditor's dismissal or resignation? If so in cases of dismissal or resignation, should the credit union be required to include reasons for the dismissal or resignation?

Notification to the NCUA every time a credit union engages an auditor does not appear to be useful in the supervisory process. However, the dismissal or resignation of an auditor outside the original terms of the engagement may raise alarms and such notification may be useful to supervisors. A routine rotation of auditing firms at the end of a contract period should be excluded from any such requirement.

22. NCUA recently joined in the final _Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters_, 71 FR 6847 (Feb. 9, 2006). Should credit union Supervisory Committees be prohibited by regulation from executing engagement letters that contain language limiting various forms of auditor liability to the credit union? Should Supervisory Committees be prohibited from waiving the auditor's punitive damages liability?

Credit union Supervisory Committee members should be prohibited from executing engagement letters that contain language that limits various forms of auditor liability. Although these provisions may reduce costs in some cases, such provisions may weaken the external auditors' objectivity, impartiality, and performance. Waiver of punitive damages provisions are more acceptable since these are damages over and above any actual damages the credit union may recover. However, provisions to indemnify external auditors for third party punitive damage awards should be prohibited.

Sincerely,

Theresa Trimble,
Chairperson, Board of Directors

Sincerely,

Terrill Garrison, CPA
Chairperson, Supervisory Committee

FRB Federal Credit Union
P.O. Box 9867
Washington, DC 200016
3871 Fax (202) 833 - 2142