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April 20, 2006

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

Dear Ms. Rupp,

The National Credit Union Administration requested public comment on whether and how to modify its Supervisory Committee audit rules to require credit unions to obtain an "attestation on internal controls" in connection with their annual audits; to identify and impose assessment and attestation standards for such engagements; to impose minimum qualifications for Supervisory Committee members; and to identify and impose minimal qualifications for independence required of State-licensed, compensated auditors. The following comments are provided in response to your request:

A. Internal Control Assessment and Attestation

1. *Should part 715 require, in addition to a financial statement audit, and "attestation on internal controls" over financial reporting above a certain minimum asset size threshold?*

   Part 715 should not require an "attestation on internal controls" in addition to a financial statement audit for the following reasons:

   - Credit unions are not publicly traded and there is no need or motivation to falsify financial statements to attract or appease investors.

   - Credit unions have a simple accounting structure that does not present opportunities for manipulation of the financial statements as has been found in the public sector.

   - The credit union industry is highly regulated and monitored. The regulations do not permit credit unions to participate in activities or investments that carry the same level of risk as other institutions.

   - The credit union industry has a history of strength and stability that supports the effectiveness of the existing requirements of Section 715.

   - According to most experts, the cost for compliance with Section 404 of the Sarbanes-Oxley Act by the public sector has far exceeded the benefit.

- The SEC's Advisory Committee on Smaller Public Companies acknowledged that smaller companies have been disproportionately subject to the burdens associated with Section 404 compliance. The Advisory Committee recommended that smaller companies be given exemptive relief from the requirements of Section 404 until a cost effective framework for assessing internal controls over financial reporting that recognizes the characteristics and needs of smaller companies is developed.

- Even the largest credit union is smaller and less complex than the typical small public company.

- The credit unions' Boards of Directors are volunteers (uncompensated) and have no self-interest in the credit union income or financial statements.

- Credit union income is retuned to the members through lower interest rates on loans and higher dividends on deposits, and through investments in employee training and technology to provide better service. The high cost for compliance with the proposed changes to part 715 would negatively impact members and the credit union industry as a whole.

2. *What minimum asset size threshold would be appropriate of 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.*

   Again, we do not believe that an attestation should be required, but if it is, the asset size threshold should be significantly higher than the $1 billion threshold set by the FDIC Improvement Act requirement for banks (perhaps $20 billion). Small banks are more complex and riskier than even the largest credit unions.

   Banks have the authority to invest in assets that carry more risk, and obtain financing through more complex borrowing instruments. The banks' corporate structure is different. Shareholders and Directors of banks directly benefit from the banks' profits.

   Credit unions, regardless of asset size, lack the motivation to falsify their financial reports because of the non-profit corporate structures.

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.*

   If an "attestation on internal controls" is required, the minimum asset size for a corporate credit union should be higher than that of a natural person credit union. Corporate credit unions have fewer members and a less complex balance sheet and operations than a natural person credit union.

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?*

   Regulatory reporting for credit unions with total assets exceeding $10 million must comply with GAAP. The "attestation on internal controls" should be accomplished for both GAAP and regulatory reporting without additional cost.

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.*

   The same external auditor should be permitted to perform both the financial statement audit and the "attestation on internal controls. It would be a waste of member funds to engage different auditors to perform the "attestation on internal controls" and the financial statement audit. The financial statement auditor would still need to perform certain due diligence procedures to ensure the quality of the "attestation on internal controls."

   The credit union should, however, retain the option of engaging more than one external auditor or having the internal audit department perform the "attestation on internal controls."

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

   If an "attestation on internal controls" by an external auditor is required, it should be required every three to five years. The periodic attestation by the external auditors could be supported by a more frequent periodic requirement for the CEO to report to the Board of Directors and the Supervisory Committee on management's assessment of the design and operational effectiveness of the internal control system.

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)?*

   If an "attestation on internal controls" is required, it should become effective for fiscal periods beginning after December 15, 2010. Credit unions will need a considerable amount of time to prepare for compliance. The NCUA will also need time to provide additional guidance for conducting and documenting a cost-effective self audit of internal controls.

B. Standards Governing Internal Control Assessments and Attestations

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 of 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.*

   The AICPA's revised AT 501 standard should be used if credit unions are required to obtain an "attestation on internal controls," because it specifically applies to non-public companies.

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

   COSO's framework should <u>not</u> be used as the standard for credit union management because it was developed for more complex public companies and it does not provide management with guidance on how to document and test internal control or how to evaluate deficiencies. Further, the SEC's Advisory Committee on Smaller Public Companies found that COSO's framework is not cost effective for assessing internal controls for small companies.

   We recommend that the NCUA develop its own standard that all credit union management must follow when establishing, maintaining and assessing the effectiveness of the internal control structure and procedure.

C. Qualifications of Supervisory Committee Members

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 be required to meet and what should the minimum asset size threshold be?*

    Minimum experience or expertise requirements for the Supervisory Committee should not be established. To do so may limit credit unions' ability to recruit and retain volunteers to serve on the Supervisory Committee. The potential liability may be greater for an "expert" serving in a volunteer capacity.

    Larger credit unions generally have an internal audit department in addition to the external auditors to assist the Supervisory Committee in the discharge of their duties. Supervisory Committee members of smaller credit unions may need greater experience and expertise because they are directly responsible for more duties.

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?*

    Regardless of asset size, Supervisory Committee members should be permitted access to outside counsel if (in the opinion of the Committee members) such access is needed to fulfill their responsibilities.

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?*

    The Supervisory Committee members should be independent in fact and in appearance regardless of the credit union's asset size. To prevent conflicts of interest, association with large vendors or third-party providers should be prohibited.

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

    As noted in the response to question 10, imposition of experience and expertise requirements would limit the ability to recruit and retain Supervisory Committee volunteers. Individuals with these skills are highly marketable and would probably not have the time available to serve as a volunteer.

D. Independence of State-Licensed, Compensated Auditors

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?*

    The state-licensed, compensated auditor who performs a financial statement audit and/or "internal control attestation" should only be required to meet the AICPA's "independence" standards. Credit Unions are not publicly traded and SEC standards do not apply.

E. Audit Options, Reports and Engagements

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?*

    Retaining the "balance sheet audit" for small credit unions would be more cost-effective, and would not materially increase risk to the industry.

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

    Retaining the "Supervisory Committee Guide Audit" for small credit unions would be more cost-effective, and would not materially increase risk to the industry.

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?*

    A copy of the financial statements should be forwarded to the NCUA within 30 days of issue and receipt by the credit union.

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?*

    A copy of a credit union's management letter (or other report issued by its external auditor) should be forwarded to the NCUA within 60 days of issue and receipt by the credit union. This timeframe would allow the credit union time to prepare a response to accompany the management letter.

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

    If required to forward external auditor reports to the NCUA, the reports should first be reviewed with the Supervisory Committee.

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 date within its engagement letter?*

    The current target date of 120 days is reasonable; however, extending the target date to 150 or 180 days after the audit period-end would help to reduce audit fees by allowing the external auditors to perform fieldwork during their non-busy season.

Rather than impose sanctions against credit unions that fail to include the target date within its engagement letter, NCUA should instruct examiners to consider such failure during evaluation of management practices.

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?*

    Part 715 should not require the NCUA be notified when a new audit firm is engaged by the Supervisory Committee; however, the dismissal or resignation of the audit firm prior to the completion of an engagement may be an indication of a problem. The credit union should be required to notify the NCUA in these circumstances and include the reasons for the dismissal or resignation.

22. *NCUA recently joined in the final <u>Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters,</u> 71FR6847 (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?*

    Yes, the Supervisory Committees should be prohibited by regulation from executing engagement letters that limit the auditor's liability to the credit union.

Lockheed Federal Credit Union appreciates the opportunity to provide comments in response to the NCUA's Advanced Notice of Proposed Rulemaking for Part 715, Supervisory Committee Audits.

Sincerely,

Dave Styler
President and CFO

Cc: Supervisory Committee