

April 26, 2019

National Credit Union Administration
Gerald Poliquin, Secretary of the Board
1775 Duke Street
Alexandria, VA 22314-3428

RE: Comments on Proposed Rule - Supervisory Committee Audits and Verifications; RIN 3133-AE91

Dear Mr. Gerald Poliquin,

I am writing on behalf of the California and Nevada Credit Union Leagues (Leagues), one of the largest state trade associations for credit unions in the United States, representing the interests of more than 240 credit unions and their approximately 11 million members.

The Leagues applaud the NCUA Board (Board) for its efforts to clarify and simplify the audit process for federally insured credit unions (FICUs) with assets less than \$500 million. The Leagues generally agree with and support the proposed amendments and we offer the following comments on the proposal.

Background

The Federal Credit Union Act (FCU Act) sets forth provisions addressing auditing and accounting requirements. Section 202(a)(6) of the FCU Act grants authority to the Board to prescribe audit standards and establishes certain requirements based on charter type and asset size thresholds.

NCUA's regulations implement the requirements of the FCU Act. Specifically, Parts 715.5 and 715.6 specify: (1) The minimum type of annual audit a FICU is required to obtain according to its charter type and asset size; (2) the licensing requirements of persons performing certain audits; and (3) the auditing principles that apply to certain audits.

Part 715.7 outlines the options for a FICU having assets less than \$500 million to comply with the annual audit requirement if it has elected not to voluntarily obtain a Financial Statement Audit. The options permitted include a FICU obtaining:

- a. A Balance Sheet Audit;
- b. A Report on Examination of Internal Controls over Call Reporting; or
- c. An Audit per the *Supervisory Committee Guide*.

Proposed Amendments

715.7(b) – Report on Examination of Internal Control over Call Reporting

The proposed rule eliminates the option to obtain a Report on Examination of Internal Controls Over Call Reporting as one of the alternatives to a Financial Statement Audit. The NCUA notes that as of September 30, 2018, less than 1 percent of FICUs used this option to fulfill their audit requirement. The Leagues agree with the NCUA's opinion that this option has limited value in serving as an audit of the credit union's financial reports of condition as it does not necessarily involve any review of balances reported. For these reasons the Leagues support this amendment.

715.7(c) – Audit per Supervisory Committee Guide

Another option for applicable credit unions is to conduct an audit using the *Supervisory Committee Guide (Guide)*. The Board is proposing to replace this alternative with the option to conduct the audit so as to meet certain minimum requirements, which would be incorporated into a proposed new Appendix A to Part 715. The Leagues support the proposed change and agree with the NCUA that providing a targeted list of minimum procedures to be included in an audit would clarify and simplify the audit process.

Appendix A to Part 715

The minimum procedures proposed in Appendix A reflect common industry practices for testing accounts and controls over financial institution financial statements. Under the proposed Appendix A, the supervisory committee, internal auditor, or other qualified person would be required to perform and document the following five areas of review:

1. Test and confirm material asset and liability accounts, including, at a minimum, loans, cash, investments, shares and borrowings.
2. Test material equity, income and expense accounts.
3. Review key internal controls, at a minimum, bank reconciliation procedures, cash controls, dormant account controls, wire and ACH transfer controls, loan approval and disbursement procedures, and inside account controls.
4. Test the mathematical accuracy of the allowance for loan and lease loss accounts and ensure the methodology is properly applied.
5. Test loan delinquency and charge-offs.

Appendix A further directs the supervisory committee, internal auditor, or other qualified persons to determine if additional procedures are needed to supplement the minimum procedures that are subject to the audit. The Leagues agree this flexibility is needed.

In addition, the proposed rule indicates the agency will issue reference material on how to conduct procedures that would meet the minimum requirements of new Appendix A. This reference material could be used by Supervisory Committees and hired third parties to develop agreed upon procedures or, alternatively, to incorporate other agreed upon procedures if the testing resulted in the minimum requirements being met. The Leagues agree with this approach on the use of the reference material as it provides FICUs with additional flexibility.

Proposed Appendix A is intended to make it easier for credit unions to understand what they need to include in their audits, not necessarily to change the areas of review the Board considers important. Nevertheless, the Board requests comment on if there are other areas of review that should be included in Appendix A. Because of the damage insider fraud can do to individual credit unions, the National Credit Union Share Insurance Fund, and the reputation of the entire credit union system, it is important that audits include processes to help deter and detect insider abuse. As part of the review of key internal controls, the Leagues recommend Appendix A include a review of insider activity, including loans to insiders.

Section 715.9 – Assistance from Outside, Compensated Person

Section 715.9, among other things, addresses engagement letters a credit union may use to hire a compensated auditor to perform audit functions. The current regulation requires that an engagement letter specify a target date of delivery of written reports “not to exceed 120 days from the date of calendar or fiscal year-end under audit.” The Board proposes to eliminate the 120-day time frame in favor of language that provides enhanced flexibility free of any deadline articulated in a specific number of days. The new standard would only require a credit union to specify in the engagement letter a target delivery date that enables the credit union to timely meet its annual audit requirements. The Leagues agree with the amendment as it provides credit unions with additional flexibility and the ability to better negotiate the target date for delivery of written reports.

Conclusion

The Leagues thank the Board for the opportunity to comment on the proposed amendments. The proposed rule helps clarify and simplify the audit process for FICUs with assets less than \$500 million and provides FICUs with additional flexibility.

If you have any questions regarding our comments, please contact me.

Sincerely,

Diana Dykstra
President and CEO
California and Nevada Credit Union Leagues

cc: CCUL