

Chapter 5

SUPERVISORY COMMITTEE

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Chapter 5

SUPERVISORY COMMITTEE

Examination Objectives

- Determine the necessary supervision and examination scope based on the review of the supervisory committee audit, internal audit reports and risk management reports
- Determine whether the supervisory committee audit and verification meets the requirements of §715 and §741.202 of the *NCUA Rules and Regulations*
- Determine if the supervisory committee performs other duties to meet their fiduciary responsibility
- Determine the advisability of other audits (e.g., e-commerce, internal control, *Statement of Auditing Standard (SAS) No. 70*, etc.)

Associated Risks

- Compliance risk – Includes the risk that the audit and verification does not comply with the laws and regulations;
- Reputation risk – Includes the risk that the supervisory committee did not meet its fiduciary duties, resulting in poor publicity or administrative action;
- Strategic risk – Includes the risk that management fails to act on recommendations included in examinations or internal/external audits, or did not allocate the necessary resources to implement proper internal controls; and
- Transaction risk – Includes the risk that internal controls do not sufficiently deter or detect errors, omissions or material misstatements.

Overview

Reviewing the supervisory committee audit is a required and important aspect of the annual examination. The quality of the audit helps examiners determine the depth of their review. A quality audit can lead to examiner confidence in the records and thereby limit the extent of review. Conversely, a poor audit may necessitate expanding the examination scope.

The examiner should ensure that persons performing the audit and verification functions performed them in accordance with §715 of

NCUA's Rules and Regulations. The examiner's review and evaluation of these functions serve as key elements in determining the examination's scope. Examiners will complete the required questionnaire, SC- Pre-Examination Supervisory Committee Audit And Verification Review.

Additionally, examiners may also complete the following optional questionnaires depending on the type of audit performed:

- SC-Financial Statement Audit by CPA (described in Appendix A);
- SC-Balance Sheet Only Audit by CPA (described in Appendix A);
- SC-Examination of Internal Control over Call Reporting by CPA (described in Appendix B); and,
- SC- Non-Opinion (described in Appendix C or D).

**Scope
Development
and Planning**

The following documents can provide guidance for the examiner during the scope development and planning phase:

- Any report of reportable conditions or material weaknesses (sometimes referred to as a management letter);
- The annual audit report;
- Engagement Letter;
- Internal audit reports, if any;
- Risk management or any other applicable audits, if any;
- Support for the verification of accounts; and
- Minutes of the supervisory committee meetings;

**Meeting with the
Supervisory
Committee**

The examiner may arrange a meeting with the chairman of the supervisory committee to:

- Explain the examiner's mission in reviewing the audit and verification functions;
- Discuss the supervisory committee's role and responsibilities, if necessary (§715.3);
- Answer any questions the supervisory committee may have; and
- Determine the extent of the committee's knowledge of the credit union's operations, management, and the status of the credit union's financial condition.

Meeting with the Internal Auditor

The examiner may arrange a meeting with the internal auditor to:

- Evaluate the independence and experience of personnel conducting internal control reviews, adequacy of staff size, appropriateness of audit schedule, and sufficiency of scope;
- Assess the reliability and effectiveness of any internal control review;
- Review audit reports, letters reporting material weaknesses or reportable conditions, and management's written response to auditors' findings; and
- Review internal audit working papers.

Meeting with the External Auditor and Review of Working Papers

The type of audit and the examiner's familiarity with the external auditor will determine the extent of the meeting and review of the audit working papers. If examiners choose to contact the external auditor, they may find it beneficial to obtain the auditor's risk assessment, their conclusions, and resulting modifications to the audit program, including the following:

- Auditor memorandums relating to audit planning, preliminary analytical procedures, materiality thresholds, discussions with management, etc; and
- Working papers related to general risks (client's business and industry; significant changes; materiality; general summary of internal controls; and general assessment of risk) and the auditor's assessment detailing conclusions reached.

To clarify the auditor's risk assessment as it relates to the examination scope, the examiner should ask about the following:

- Significant accounts (higher risk is generally localized in a few account balances);
- Risk level assessed (low, moderate, high) for inherent, control, detection, and assertions risk for each significant account.

Inherent risk plus Control risk = Risk of Material Misstatement (RMM);

- Risk factors in place to mitigate risk (e.g., monitoring by third parties, inquiry or observation of controls, prior audit experience, and procedures performed in understanding and testing controls provide evidential matter);
- Conclusions and findings of control testing. **No assurance = Maximum control risk;** and
- The auditor's assessment of combined risk (RMM) and resulting determination of audit program steps.

The examiners' understanding of these aspects of the auditor's work may help them plan and determine the examination scope. If examiners decide to review the supervisory committee and its functions, but have not obtained the information discussed above in the planning phase, they should obtain these items early in the fieldwork phase to minimize duplication of effort, when possible. If the examiners cannot rely on the work of the external auditor, they may need the duplication of efforts to properly assess risk areas.

Reviewing the Annual Supervisory Committee Audit

NCUA Rules and Regulations §715.4-§715.8 set forth the minimum requirements for a supervisory committee audit and verification consistent with the *FCU Act* §115. Supervisory committees often engage external auditors to assist them in meeting this requirement.

The approach the examiner should take in reviewing the audit depends on the type of audit for which the supervisory committee contracted:

- Financial statement opinion audit (Appendix A);
- Balance sheet only opinion audit (Appendix A);
- An examination of internal controls over call reporting (Appendix B); or
- Other supervisory committee audits such as:
 - CPA Agreed-Upon Procedures Audits (Appendix C); and
 - Non-opinion audits (Appendix D).

Certain circumstances may prompt the examiner to consider requiring an independent audit performed by a CPA. Refer to §715.11, Sanctions for failure to comply with this part, and §715.12, Statutory audit

remedies for Federal Credit Unions, of the *NCUA Rules and Regulations*.

**Reviewing
the
Engagement
Letter**

NCUA Rules and Regulations §715.9 (b), Engagement letter, requires that the supervisory committee obtain an engagement letter when they hire a compensated auditor. Also, §715.9(c), Contents of the letter, §715.9(d), Complete scope, and §§715.9(e), Exclusions from scope, discuss the minimum requirements for such an engagement letter.

CPAs generally submit engagement letters to the supervisory committee before beginning their work. The examiner should review the engagement letter in light of §§715.9 (b) through (e) to determine if the supervisory committee properly contracted for the audit. Examiners may find these letters a source of valuable information. These letters include, among other things, the audit scope, the audit period, and the expected reports. In many cases, the auditor will summarize highlights of these matters in the body of the letter and provide greater detail in schedules or appendices to the letter. The letter may specify procedures for various audit areas. In addition, it may specify any limitations on the auditor's scope, including omission of auditing procedures (e.g., evaluation of the allowance for loan losses or confirmation of loans or deposits, if required.)

Sometimes, a supervisory committee can predetermine an unacceptable audit simply by failing to include necessary items (scope, timing, delivery, etc.) Examiners should review the Engagement Letter to ensure the supervisory committee contracted for an acceptable audit. §715.9 of the *NCUA Rules and Regulations* encourages improved contracting practices with the goal of improving compliance with regulatory requirements for audits.

Engagement letter provisions particularly helpful to the examination process, if enforced, include:

- Timely delivery of the audit report within 120 days of completion of the period under audit (§715.9(c)(6));
- Except for opinion audits, the appendix to the letter setting forth the agreed upon procedures (§715.9(c)(3));

- Certified scope, or alternatively a list of exclusions from scope and qualifying reminder that the supervisory committee remains responsible for excluded scope (§715.9(d)(e)); and
- A clause to the effect that the independent accountant agrees to permit the regulator to review and to photocopy applicable original working papers, as the regulator may request (§715.9(c)(7)).

**Finding an
Audit or
Verification
Unacceptable**

Examiners may consider an audit or verification unacceptable and may develop plans of action when they determine:

- The audit scope did not include material areas of the credit union operations;
- Working papers do not support material parts of the audit; or
- Lack of independent control over the verification process.

When examiners take exception to the annual supervisory committee audit, they should convey the following information to the credit union and document it in the examination working papers:

- Specific audit sections in question;
- Records or accounts with significant errors or record keeping deficiencies; and
- Time anticipated for resolving the problems.

Examiners should consult with their supervisory examiners, and in state-chartered credit unions the state supervisory authority, before enforcing *NCUA Rules and Regulations* §715.11, Sanctions for Failure to Comply With This Part and §715.12, Statutory Audit Remedies for Federal Credit Unions.

**If Compensated
Auditor's Audit
Appears Lacking**

When examiners have concerns with the acceptability of the CPA's work, they have several options available. At a minimum, they should sit down with the CPA and discuss their concerns. The meeting will serve as a fact-gathering opportunity that assists the examiner in determining whether the auditors used additional audit steps and if so, how they used the additional steps. Examiners must maintain their objectivity and independence, and should reserve adverse, constructive comments for the final meeting with the supervisory committee. If the

supervisory committee agrees with the examiner's conclusions, they should together determine timeframes for making the corrections.

If, after reviewing the audit working papers and discussing concerns with the independent accountant, examiners have not satisfied themselves that the independent accountant met the minimum requirements of the audit, they should consult with their supervisory examiners. Examiners should clearly describe the circumstances, procedures followed, findings, and conclusions in their working papers. If examiners cannot determine adequate completion of certain audit steps or if they have concerns with independence or thoroughness, they should discuss all major audit findings with the supervisory committee and document the discussion in their working papers. Additionally, an examiner may:

- Recommend that the supervisory committee perform the additional tests in the coming year, before the next examination, to provide NCUA with needed assurances; or
- Recommend that the board and supervisory committee include additional special procedures in engagement letters of future audits.

In extreme, rare, and well-documented instances, supervisory examiners should consult with the regional director or associate regional director regarding cases that may require forwarding referrals through the Office of Examination and Insurance to either the state licensing authority, the AICPA Ethics Division, or to take other action as the Office of General Counsel may advise.

In such cases, examiners should not rate the audit itself unacceptable even though they cannot determine evidence of the satisfactory completion of various test checks or audit procedures. NCUA's policy is that independent, licensed, certified public accountants have established and documented auditing standards which govern their work, whether "opinion" audits (GAAS) or "agreed-upon procedures" engagements (refer to SSAE No. 10). Before examiners find audits "unacceptable" in meeting §715, they should request that Central Office program and legal staff perform a review in relation to the professional accounting and auditing standards, and the likelihood of prevailing (cost/benefit) should the agency decide to proceed legally.

NCUA recognizes that independent accountants can err. Therefore, agency policy encourages examiners to review and to question, when appropriate, an independent accountant's work. However, examiners should stop short of labeling the audit "unacceptable", unless NCUA can solidly assert that the CPA fell short of this standard and support this assertion in a due process proceeding.

**Reviewing
the Internal
Audit
Department**

Internal auditors can serve several valuable functions. They appraise the soundness and adequacy of accounting, operating and administrative controls.

The success of the internal audit function depends in large part on the independence maintained by internal audit personnel. Internal auditors should report directly to the supervisory or audit committee, rather than to management. This enables the function to be "free from influence" of management and, to some degree, the board of directors.

The major factors that the examiner must consider while reviewing and evaluating the internal audit function are (1) the independence and thoroughness of the internal auditors, and (2) the adequacy and effectiveness of the audit program.

The qualifications and responsibilities of internal auditors vary with the credit union's size and complexity and the emphasis that the board places on the audit function. In some credit unions, auditors have no other responsibilities beyond the internal audit function; in others, they are regular employees with part-time audit duties.

Examiners should satisfy themselves that audit staff supervisors possess an adequate knowledge of audit objectives and an understanding of the audit procedures performed by the staff.

The final measure of the auditor's thoroughness is the quality of the work performed and the ability to communicate the results of that work. Accordingly, the examiner's conclusions should reflect the adequacy of the audit program and the audit reports.

**Internal Audit
Program
Adequacy**

The examiner should consider the following:

- Scope and frequency of the audit work;
- Documentation of the work performed;
- Content of the audit programs; and
- Conclusions reached and reports issued.

A documented record of the work performed (best created through audit working papers) must exist. These working papers should contain, among other things, audit work programs and analyses that clearly indicate the procedures performed, the extent of testing, and the basis for the conclusions reached.

Audit work programs deserve separate attention. The work programs, normally found in large complex credit unions with internal audit departments, serve as the primary evidence of the audit procedures planned and performed. As such, they should be written and should cover key areas of a credit union's operations. Each program should provide a clear, concise description of the audit work required, and present individual audit procedures logically. The detailed procedures included in the program will vary depending on, among other factors, the size and complexity of the credit union's operations. Most audit programs should include:

- Surprise audits, where appropriate;
- Maintenance of control over records selected for audit;
- Review and evaluation of the credit union's policies and procedures and the system of internal control;
- Proof of detail to related control records; and
- Verification of selected transactions or balances.

Completion of the specific procedures included in all work programs should enable the internal auditor to reach conclusions that will satisfy the related audit objectives. The work performed should support conclusions drawn and audit reports prepared from the work program results. When appropriate, the reports should include the internal auditor's recommendations for required remedial actions.

Prompt and effective management response to the auditor's recommendations is the final measure of the audit program's effectiveness.

Internal Audit Review

The examiner's review and evaluation of the internal audit function are key elements in determining the scope of the examination. Based on careful evaluation, examiners should conclude whether they find the work performed by the internal auditors acceptable, partially acceptable, or not acceptable.

The concept of partial reliance or acceptability applies only to the review and evaluation of the internal audit function. The examiner may detect weaknesses in the internal audit function or procedures that are not of such magnitude to make the internal audit function unacceptable. In such situations, the examiner should draw a partially acceptable conclusion.

Verifications

NCUA requires federal credit union supervisory committees to verify the members' accounts with the credit union's records at least once every two years. *NCUA Rules and Regulations* §715.8, Requirements for verification of accounts and passbooks, provides that the supervisory committee (or their representative) can base the verification on a 100 percent sample, a random statistical sample, or, for CPAs only, a non-statistical sampling option. Examiners should refer to Chapter 24 of the Supervisory Committee Guide, "What Must a Verification Involve?"

Working Paper Access

In reviewing the audit, the examiner should determine if the auditor properly documented completed audit procedures in working papers in support of the audit or verification report. The *NCUA Rules and Regulations* §715.10, Audit report and working paper maintenance and access, requires the committee to maintain adequate working papers to support its audits.

The auditor's working papers include all the evidence gathered to show work done, the methods and procedures followed, and the conclusions reached. There are no standard working papers. The committee or

auditor prepares working papers that best serve their intended purpose. The working papers should:

- Coordinate and organize all phases of the audit;
- Facilitate preparation of the final audit report; and
- Substantiate in detail the opinions and findings in the report.

When the supervisory committee performs the verification or audit, the examiner generally has little or no difficulty accessing the original working papers. These papers form the basis for judging the adequacy of a supervisory committee audit.

Examiners may have more difficulty obtaining the working papers when the supervisory committee directs a CPA to complete some or all of the work. Independent accountants generally consider the working papers confidential and the property of the accounting firm. The CPA may ask that the examiner:

- Sign a document before obtaining access to working papers; and/or
- Review the working papers in the CPA's office.

In the latter case, the auditor may also require the presence of an employee during the examiner's review. With the exception of signing a waiver document, the examiner should cooperate as fully as possible with these practices.

Signing Waiver Document to Gain Working Paper Access

It is NCUA's policy that examiners not sign waiver letters. Most letters go beyond simply acknowledging receipt of the working papers. The letters often contain qualifying language and restrictions on the regulator's use of information obtained in the working papers.

Supervised Access

Reviewing working papers may require significant time and travel when the auditing firm is not local. In such instances, the examiner-in-charge may arrange through the supervisory examiner for another examiner to review the working papers. While auditing firms generally permit examiners supervised access, some will not permit examiners to photocopy original working papers. Regional or national accounting firms often have this policy. An examiner should not take exception to

the denial of photocopying privileges unless it clearly and directly affects the examiner's ability to discern and document the audit's acceptability.

Denial of Access In rare instances, an independent auditor may refuse the examiner access to working papers. The examiner should then contact the supervisory committee chairman for help in getting access to the papers. *NCUA Rules and Regulations* §715.10(b), Working papers, requires allowing the examiner access to original audit working papers. If the auditor still refuses, examiners should notify the supervisory committee that they could rate the auditor's work unacceptable and possibly require the supervisory committee to re-do it. With some of the larger firms, the Office of Examination and Insurance (E&I) can assist in obtaining examiner access by contacting and interceding at the national level.

Examiners should reserve comments about audit working papers until they finish the review and develop an overall picture of the work's adequacy. After completing the review, the examiner discusses the findings with the auditor and the supervisory committee.

Addressing Deficiencies with the Supervisory Committee Examiners should reach specific agreements with the supervisory committee to correct deficiencies during the next audit or verification or within a reasonable time. Examiners should request that the board president invite the chairman or whole committee to the joint conference or exit interview.

Mandatory Auditor Rotation If a credit union has used a particular external auditor for a series of years, and the independence, competence, and level of audit work is otherwise adequate, examiners should not recommend that the credit union routinely rotate external auditors. Examiners should not suggest auditor rotation for rotation-sake. If examiners have concerns about the quality of the audit, they should document these specific concerns and raise them with the supervisory committee. The questioning of a particular auditor's quality of work and citing of §715.11 and §715.12 in applicable circumstances will most likely bring the supervisory committee to its own conclusion to hire another auditor.

**Other
Committee
Duties**

The supervisory committee has responsibilities beyond the audit and verification functions. These additional duties (Chapter 4 of the Supervisory Committee Guide) include (1) resolution of member complaints; (2) strengthening internal controls; (3) authority to call special membership meetings and remove officers, directors, or credit committee members; and (4) reviewing management's corrective action.

**Working
Papers and
References**

- Working papers
 - Scope Workbook
 - Supervisory Committee Questionnaires
(Required) SC - Supervisory Committee Audit and Verification Review; and
(Optional) depending on the type of audit performed:
SC-Financial Statement Audit by CPA;
SC-Balance Sheet Only Audit by CPA;
SC-Examination of Internal Controls over Call Reporting by CPA; and,
SC- Non-Opinion

- References
 - *Federal Credit Union Act*
 - 111 - Compensation
 - 115 - Supervisory Committee
 - *Federal Credit Union Bylaws*
 - Article IV (12/87 and 10/91)– Meeting of Members
 - Article V (10/99) - Meetings of Members
 - Article X (12/87 and 10/91)- Supervisory Committee
 - Article IX (10/99) – Supervisory Committee
 - *NCUA Rules and Regulations*
 - 715 - Supervisory Committee Audit
 - 741.202 – Requirements for Insurance
 - *Supervisory Committee Guide*
 - AICPA Audit and Accounting Guide (relevant to Credit Unions)

OPINION AUDITS - APPENDIX 5A

Reviewing Financial Statement or Balance Sheet Only Opinion Audits

An “opinion audit” expresses an opinion on the fair presentation of the financial statements in all material respects in accordance with generally accepted accounting principles (GAAP). These audits include the following:

- A financial statement audit - the auditor will audit the balance sheet, income statement, statement of equity and other comprehensive income, and statement of cash flows, and will present an opinion on all the statements, taken as a whole; or
- A balance sheet only audit - the auditor will audit the balance sheet and render an opinion. That means the auditor will not audit the income statement accounts, statement of equity and other comprehensive income, and statement of cash flow information.

The objective of an independent, licensed CPA conducting an audit differs from the objectives of an internal audit or an NCUA examination. In unusual situations, the examiner may conduct an in-depth review of the thoroughness and independence of the CPA or the adequacy of the CPA's audit.

The American Institute of Certified Public Accountants (AICPA) establishes standards for thoroughness and independence of CPAs, the auditing standards CPAs must follow in connection with their audits of financial statements, and standards governing CPAs’ reports. Not all CPAs are members of the AICPA; however, all must follow professional standards adopted, whether by their respective state societies or the state agency issuing their licenses.

Peer Review

Accounting firms receive a peer review (a quality control-type review) performed by another (external) certified public accounting firm on a regular basis (every two to three years). Examiners should request and review a copy of the most recent peer review report. They should note any areas that may trigger expansion of procedures or reduced reliance on the audit and verification.

Professional Standards

Generally accepted auditing standards¹ (GAAS) are the standards an independent accountant's opinion audit must meet. GAAS falls into three categories: general standards, standards of fieldwork, and standards of reporting.

The general standards require that the person performing the audit:

- Have adequate technical training and proficiency;
- Maintain an independence in mental attitude; and
- Exercise due professional care in the performance of the audit and the preparation of the report.

Review of Independence

CPAs must remain independent of those they serve. Independence is defined as the ability to act with integrity and objectivity. Ordinarily, the examiner will not need to test for independence. However, the examiner may occasionally have sufficient reason to question a CPA's independence or the quality of the work.

The examiner should investigate a recent change in CPAs by a credit union, particularly if the change occurred after an audit began.

The examiner should also investigate if the CPA:

- Has a direct financial interest in the credit union;
- Is connected with the credit union in a capacity equivalent to that of a member of management or was a director of the credit union;
- Maintains, completely or in part, the books and records of the credit union and did not perform audit tests with respect to such books and records; or,
- Has received from the credit union an unsecured loan considered material in amount relative to the net worth of the borrower.

In such instances (the above list is not inclusive), the CPA would not have complied with professional standards. Accordingly, the examiner should not rely on any work performed by the CPA without reviewing

¹ Auditing standards, as distinct from auditing procedures, are concerned not only with the auditor's professional qualifications, but with the judgment exercised in the performance of an audit and with the resulting reports.

the procedures followed in the audit. The examiner should perform a review of the CPA's working papers. If the procedures satisfy the Part 715 requirements, the examiner can rely on the work performed.

If an examiner remains concerned that the auditor has not complied with independence standards, the examiner should document these concerns and follow the guidance detailed in the Supervisory Committee chapter. Examiners should not state, either orally or in examination reports or working papers, that they question the CPA's independence.

**Review of
Compliance
with Fieldwork
Standards**

Fieldwork standards require the following:

- Adequately planned work;
- Properly supervised assistants, if any;
- Proper study and evaluation of existing internal controls as a basis for reliance thereon for determining the audit scope and procedures, including the extent of testing; and
- Sufficient evidence to afford a reasonable basis for an opinion regarding the financial statements under audit.

The examiner may occasionally have sufficient reason to question a CPA's thoroughness. If the examiner questions thoroughness, the examiner should not rely on any work performed by the CPA without reviewing the procedures followed in the audit. If the procedures satisfy the Part 715 requirements, the examiner should rely on the work performed.

**Review of
Audit
Procedures**

The examiner should review the last report issued by the CPA. If an audit is currently in progress, the examiner may review the engagement letter, the auditors' risk assessment, and their conclusions and resulting modifications to the audit program.

The examiner should obtain and review any adjusting journal entries suggested by the CPA to determine if such entries are normal recurring accruals or if the entries indicate inadequate accounting records.

**Audit
Documen-
tation
Standards for
Financial
Statement
Audits**

Audit documentation (work papers) provides the principal support for the auditor's report and may serve as a resource for the examiner when developing the preliminary examination scope and risk assessment. Documentation includes, but is not limited to audit programs, analyses, memoranda, letters of confirmation, and schedules prepared or obtained by the auditor. Paper, electronic forms, or other media are acceptable.

Audit documentation illustrates the auditor's:

- Extent of planning for the fieldwork;
- Understanding of internal controls; and
- Collection of sufficient information to express an opinion.

The audit documentation supporting a balance sheet audit or an audit of the financial statements should show the examiner that the external auditor met the audit standards required by GAAS.

Audit documentation must sufficiently:

- Identify the audit team and specify who performed and reviewed the work;
- Disclose the nature, timing, extent, and results of auditing procedures performed, and the evidence obtained; and
- Establish that the accounting records reconcile with the financial statements.

The auditors consider the following when determining the documentation for an audit area:

- Risk of material misstatement (RMM) associated with financial statement assertions² or with the account or class of transactions;
- Extent of judgment involved in performing the work and evaluating the results;
- Basis for the auditing procedure;
- Significance of the evidence obtained to the assertion being tested;
- Nature and extent of exceptions identified; and

² Declaration, contention, statement.

- Need to document a conclusion, or the basis for a conclusion, not readily determinable from the documentation of the work performed.

The audit documentation must include:

- Abstracts or copies of significant credit union contracts or agreements that the auditor examined;
- Details of document inspection or confirmation, including testing of controls and substantive tests³; and
- Significant findings or issues, the action taken to address them, and the basis for the conclusions reached. Such significant issues may include accounting for complex or unusual transactions, modifications of audit procedures, and significant difficulties in applying audit procedures (e.g., problems with management during the audit).

Additional audit standards require the auditors to document:

- The auditor's understanding with the client;
- That the client has made the auditor aware of all the attorney's claims required for disclosure;
- That the auditor prepared a written audit program for every audit;
- The reasons for aggregate misstatements and the auditor's conclusions as to whether they cause material misstatement of the financial statement;
- Management's written response as to the purposes and uses of financial statements prepared in conformity with another country's accounting standards, if applicable;
- Oral communications with management regarding illegal acts that come to the auditor's attention;
- The auditor's understanding of the credit union's internal controls components (for purposes of planning the audit), and the auditor's conclusion about the assessed level of risk;
- Reportable conditions and other internal control related matters;
- Oral confirmations and if confirmations were not requested, reasons for failure to do so;

³ Independent tests that are quantitative in nature to support a financial statement assertion or contention.

- Audit requirements for governmental entities that are not included in the terms of the engagement;
- Risk of material misstatement due to fraud and the auditor's response to risk factors; and
- Written representations from management.

Additionally, before reissuing reports on prior period financial statements, the original auditor must obtain representation letters from management and any successor auditors.

Audits may also contain:

- The nature and effect of cumulative misstatements and whether these misstatements cause the financial statements to be materially misstated. (SAS 47, *Audit Risk and Materiality*). A misstatement may consist of any of the following:
 - Difference between the amount, classification, or presentation of a reported financial statement element, account, or item;
 - Omission of a financial statement element, account, or item;
 - Financial statement disclosure not presented in accordance with GAAP; and
 - Omission of information required to be disclosed in accordance with GAAP.
- The analytical procedure used to support a significant financial statement contention. They must include:
 - The factors considered in developing the expectation, if they can not be determined from the documentation;
 - The comparison results of the expectation to the credit union records; and
 - Any additional auditing procedures performed in response to significant unexpected differences arising from the analytical procedure and the results of each additional procedure.
- A statement (when an auditor doubts the ability of a credit union to continue as a going concern) that complies with (SAS 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*) discussing:

- The condition or events that led to the belief that substantial doubt exists about the credit union's ability to continue as a going concern and the auditor's conclusions regarding the credit union's ability to continue as a going concern, including the effect on the financials;
- The significant elements of management's plan in overcoming the adverse effects of the condition or events;
- The procedures performed and evidence obtained to evaluate the significant elements of management's plans; and
- Whether to include an explanatory paragraph in the audit report or a qualified or adverse opinion.

**Standards
Governing
Reporting**

The reporting standards deserve particular attention because examiners must understand CPAs and their functions. Reporting standards require that CPAs:

- Conduct their audits in accordance with generally accepted auditing standards (GAAS);
- State whether they presented the financial statements in conformity with generally accepted accounting principles (GAAP); and
- State whether such principles have been consistently applied in the current period in relation to the preceding period.

In addition, the CPA must provide reasonably adequate informative disclosures in the financial statements or otherwise in the report. The report must contain an expression of opinion regarding the financial statements taken as a whole, or an assertion that the CPA cannot express an opinion. The CPA must state in the report any reasons for the inability to express an overall opinion on the financial statements.

When no material exception exists, the CPA will issue an unqualified (clean) opinion. When a material exception exists, but not so material as to negate an opinion on the financial statements taken as a whole, a qualified opinion is appropriate. Judgment in the circumstances determines what is sufficiently material. If the matter relates to the scope of the procedures or the fairness of presentation of the financial statements, the phrase, "except for" normally appears. Only in situations where an uncertainty exists should the auditor use the phrase

"subject to". The following circumstances may require departure from the auditor's standard report:

- The credit union has restricted the scope of the audit, or conditions exist that do not permit the application of auditing procedures considered necessary in the circumstances;
- Inadequate disclosure or lack of conformity with GAAP affect the financial statements in that they do not fairly present financial conditions, results of operations, or changes in financial position;
- Consistent application of accounting principles has not occurred; or
- Unusual uncertainties exist as to the outcome of future events, and the auditor cannot reasonably estimate their effect on the financial statements.

CPAs issue an adverse opinion when the matter to which they have taken exception is so pervasive that the financial statements do not present fairly the financial position, results of operations, or change in financial position, or do not conform to GAAP.

CPAs issue a disclaimer of opinion when either the credit union or circumstances restricted the scope of their examination in important respects, or when uncertainties affect the financial statements.

In the case of a qualified, adverse or disclaimer of opinion, the auditor should set forth all material reasons for issuing the particular report form. As to limitations of scope, the report would specify the omission of any generally accepted auditing procedures and the reasons for the omission. If the credit union requested the omission, the report should so specify.

If examiners remain concerned that the CPA did not comply with general standards, the standards of fieldwork or the reporting standards, they should document the concerns and refer to the section of the Supervisory Committee chapter entitled, "If Compensated Auditor's Audit Appears Lacking" for guidance on how to proceed. Examiners should not state, either orally or in examination reports or working papers, that they question the CPA's competence.

References

- Supervisory Committee Guide
- AICPA Audit and Accounting Guide, Audits of Credit Unions
- AU Section 339, *Audit Documentation*
- Statement of Auditing Standard (SAS) No. 96
- Statement of Auditing Standards (SAS) No. 59, *The Auditor's consideration of an Entity's Ability to Continue as a Going Concern*
- Statement of Auditing Standards (SAS) No. 47, *Audit Risk and Materiality*

EXAMINATION OF INTERNAL CONTROL OVER CALL REPORTING BY A CPA - APPENDIX 5B

Engagement Performance

Performing an examination of internal control over call reporting requires that the auditor:

- Plan the engagement;
- Obtain an understanding of internal control;
- Evaluate the design effectiveness of the controls;
- Test and evaluate the operating effectiveness of the controls; and
- Form an opinion on the effectiveness of the credit union's internal control, or management's assertion, thereon, based on the control criteria. (AT 400.16)

Reviewing an Examination of Internal Control Over Call Reporting

The examination of internal control over call reporting differs from an audit of the financial statements in many ways, including the following:

- In a financial statement audit, the auditors' consideration of internal control enables the auditor to plan the audit and determine the nature, timing, and extent of testing they will need to perform. Such work forms the basis for the expression of an opinion on the fair presentation of the financial statements, taken as a whole, in all material respects in accordance with GAAP.
- In an examination of internal control over call reporting, the auditor examines management's assertion about the effectiveness of the credit union's internal control, to express an opinion about whether the credit union maintained, in all material respects, effective internal control as of a point in time based on chosen control criteria.

Accordingly, an auditor's consideration of internal control in a financial statement audit is much more limited than that of an auditor engaged to examine management's assertion about the effectiveness of the credit union's internal control over call reporting.

In examining management's assertions with regard to internal control over call reporting, the auditor can express an opinion on either of the following:

- The effectiveness of the credit union's internal control, in all material respects, based on the control criteria; or
- Whether management has fairly stated its assertion about the effectiveness of internal control, in all material respects, based on the control criteria.

The opinion relates to the credit union's internal control taken as a whole, and not to the effectiveness of each individual component.

A credit union's internal control over call reporting includes those policies and procedures that pertain to the credit union's ability to record, process, summarize, and report financial data consistent with the assertions embodied in the call report. Management may present its assertions about the effectiveness of the credit union's internal control in either a separate report that will accompany the auditor's report or a representation letter to the auditor.

An auditor engaged to examine management's assertion about the effectiveness of a credit union's internal control should comply with the general, fieldwork and reporting standards relative to "opinion audits." (See the Supervisory Committee chapter for additional information.) This appendix also discusses some additional requirements the auditor should perform.

**Management's
Assertion and
Representations**

A sample management assertion might read as follows:

... that ABC Federal Credit Union maintained effective internal control over call reporting as of [date];

or

... that ABC Federal Credit Union's internal control over call reporting sufficiently meets the stated objects as of [date].

For many credit unions, the auditor may help management draft the written assertion, which will become the subject of the engagement.

Management will also provide the auditor written representations, which may include the following:

- Acknowledging management's responsibility for establishing and maintaining internal control;
- Stating that management has performed an evaluation of the effectiveness of the credit union's internal control and specifying the control criteria used;
- Stating that management has disclosed all significant deficiencies in the internal controls that could adversely affect the credit union's ability to record, process, summarize, and report financial data in the call reports;
- Describing any fraud that involves management or other employees who have a significant role in internal control; or
- Stating whether any subsequent internal control changes occurred, including any corrective actions taken by management with regard to significant deficiencies and material weaknesses.

Management's refusal to furnish all required representations could cause the auditor to qualify or disclaim an opinion in the report.

**Control
Criteria**

By selecting the definition and description of internal control for the purpose of assessing its effectiveness, management determines the components of the credit union's internal control (AT400.12). The internal control framework most often cited, and the one most credit unions will select, based on the advice of their auditor, will most likely be *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. This definition and description of internal control includes the following five components:

- Control environment;
- Risk assessment;
- Control activities;

- Information and communication; and
- Monitoring.

This appendix does not provide an in-depth discussion of these control criteria, or of other control criteria the credit union may use. The management assertion under examination should specify and describe the control criteria management has selected for examination of the credit union's internal controls.

Engagement Performance

Some of the types of auditor functions and documentation an examiner should see when reviewing work-steps and working papers for an Internal Control Over Call Reporting engagement include the following:

- Planning the engagement:
 - Review overall strategy for the scope and performance of the engagement;
 - Understand financial reporting practices, economic conditions, laws and regulations, technological changes, organization, operating characteristics, capital structure, etc.;
 - Review preliminary judgments about materiality levels, inherent risk, and other factors relating to possible material weaknesses; and
 - Review preliminary judgments about the effectiveness of internal control (internal audit function).
- Obtain an understanding of internal control:
 - Inquire of appropriate management, supervisory, and staff personnel;
 - Inspect credit union documents; and
 - Observe credit union activities and operations.
- Evaluate the design effectiveness of the controls:
 - Understand controls within each component of internal control; and

- Focus on the significance of controls in achieving the objectives of the control criteria rather than on specific controls in isolation.
- Test and evaluate the operating effectiveness of the controls:
 - Obtain sufficient evidence to support the opinion and corroborate the results of the tests; and
 - Perform tests of controls to learn the nature of the control, significance of the control in achieving the control criteria, operating effectiveness of the control, risk of noncompliance with the control, etc.
- Form An Opinion:
 - Communicate reportable conditions and material weaknesses.
 - Report should include the following regarding the examination of Internal Control Over Call Reporting by a CPA (AT 400.45):
 - i. Title which includes “independent”;
 - ii. Identification or statement of management’s assertion about the effectiveness of the credit union’s internal control over call reporting;
 - iii. Statement that the assertion is the responsibility of management;
 - iv. Statement that the auditor’s responsibility is to state an opinion with regard to management’s assertion;
 - v. Statement that the examination was conducted in accordance with attestation standards of the AICPA;
 - vi. Statement that the examination provides a reasonable basis for the opinion;
 - vii. The opinion; and
 - viii. Auditor’s signature and date.

**Example of
Auditor’s
Written
Opinion**

Following is a sample, unqualified opinion as set forth in attestation standards (AT 400.46) that an examiner might see as the product of this type of engagement:

We have examined management's assertion included in the accompanying [title of management report], that ABC Federal Credit Union maintained effective internal control over call reporting as of December 31, 200X based on [identify stated or established criteria]. Management is responsible for maintaining effective internal control over call reporting. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of internal control over call reporting, testing, and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of internal control over call reporting to future periods are subject to the risk that internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, ABC Federal Credit Union maintained, in all material respects, effective internal control over call reporting as of December 31, 200X, based on [identify stated or established criteria].

References

- AICPA Audit and Accounting Guide (relevant to Credit Unions)

AGREED UPON PROCEDURES ENGAGEMENTS – APPENDIX 5C

Agreed Upon Procedures Audit Performed By a CPA

Supervisory committees may hire CPAs to perform a review that, in conjunction with procedures performed by the supervisory committee, meets the minimum requirements of a supervisory committee guide audit under Part 715 of the *NCUA Rules and Regulations*. Statement on Standards for Attestation Engagements (SSAE) No. 10 guides the independent accountant's performance for this type of engagement.

An agreed upon procedures (AUP) engagement is one in which the credit union supervisory committee engages an independent accountant to issue a report of findings based on specific procedures performed on specified subject matter (elements, accounts, or items of the financial statements.) The supervisory committee and the independent accountant agree upon the procedures that the supervisory committee believes the independent accountant should perform (*Supervisory Committee Guide*, Appendix A sets forth minimum procedures).

Agreement on Sufficiency of Procedures

The supervisory committee has responsibility for the sufficiency (nature, timing, and extent) of the procedures. The examiner reviews the supervisory committee function and the annual audit report for compliance with the *Federal Credit Union Act* and Part 715 of the *NCUA Rules and Regulations*.

Some independent accountants may seek NCUA's written assurance on the sufficiency of the procedures and ask NCUA to take responsibility for sufficiency of the procedures along with the supervisory committee. Examiners should not provide such assurances nor agree to NCUA's being identified as a specified user.

Standards Governing Agreed Upon Procedures by a CPA

Examiners should understand that the general (training and proficiency, adequate knowledge of subject matter, suitability and availability of criteria, independence, due professional care), fieldwork (planning and supervision, obtaining sufficient evidence, representation letter), and reporting standards for attestation

engagements govern the performance and reporting by independent accountants for these types of engagements (AT 101 and 201.)

**Examiner's
Review of
Agreed Upon
Procedures by
a CPA**

The examiner should focus on the following:

- Whether the (combined) scope of work adequately meet *NCUA Rules and Regulations* §715.7, Supervisory Committee audit alternatives to a financial statement audit, and related minimum requirements set forth in Appendix A of the *Supervisory Committee Guide*. (Scope includes aggregate work performed by the supervisory committee, audit work performed by others, and agreed upon procedures performed by a CPA.); and
- Whether individuals performing the work used procedures adequate to fulfill the scope requirements (i.e., can users place full reliance on the procedures performed.)

Scope Review

In reviewing and assessing the adequacy of the audit's scope, the examiner should use good judgment and reasonableness in what they deem acceptable. The *Supervisory Committee Guide*, Appendix A, sets forth the minimum audit scope. NCUA has provided the following in its Guide:

By publishing this Appendix, NCUA is not representing that a supervisory committee which performs or has performed these minimum procedures, and these procedures only, will have fully meet the requirements of Part 715.

The supervisory committee determines the scope of the work based on the risk, exposure, and other circumstances of the individual credit union. The supervisory committee must ensure that the audit meets the minimum requirements of *NCUA Rules and Regulations* Part 715. They cannot delegate that responsibility to a CPA. The engagement letter may omit certain key scope requirements (e.g., assessment of the reasonableness of the allowance for loan losses in the valuation of loans.) Consequently, the CPA may meet the terms of the engagement letter yet the audit scope may lack key scope requirements. The examiner should direct findings and exceptions about scope to the supervisory committee, not the CPA.

If, on the other hand, the CPA did not meet the engagement letter obligation or the examiner has independence or thoroughness concerns, the examiner should follow the procedures outlined in the Supervisory Committee chapter for taking action regarding the independent accountant.

**Review of
Procedures
Performed to
Meet Scope**

Attestation standards limit the procedures independent accountants can perform. They cannot perform procedures open to varying interpretations. Independent accountants should not use terms of uncertain meaning (e.g., general review, limited review, check, or test) to describe the procedures. Examiners should understand this aspect of professional standards when evaluating work steps performed by an independent accountant to meet *NCUA Rules and Regulations* §715.7(c) requirements.

Examples of appropriate procedures include (AT 201.17):

- Execution of a sampling application after agreeing on relevant parameters;
- Inspection of specified documents detailing attributes thereof;
- Confirmation of specific information with third parties; and
- Comparison of documents, schedules, or analyses with certain specified attributes.

Examples of inappropriate procedures include (AT 201.18):

- Evaluating the competency or objectivity of another party;
- Obtaining an understanding about a particular subject; and
- Interpreting documents outside the scope of the auditor's professional expertise.

**Findings and
Working
Papers**

Report standards require independent accountants to present the results of applying Agreed Upon Procedures to specific subject matter in the form of findings. Independent accountants should avoid vague or ambiguous language in reporting findings.

The auditor should prepare and maintain working papers appropriate to the circumstances to support the Agreed Upon Procedures engagement, i.e., quantity, type, and content. Working papers should affirm that the

auditor adequately planned and supervised the work, and obtained evidential matter to provide a reasonable basis for the finding. While the working papers remain the property of the independent accountant (in most jurisdictions), the auditor must maintain them for the NCUA's review, consistent with requirements of Part 715 of the *NCUA Rules & Regulations*.

Example of Auditor's Written Agreed Upon Procedures Findings

Following is a sample written finding of Agreed Upon Procedures as set forth in attestation standards (AT 201.32) and which may serve as the product of this type of engagement:

To the Supervisory Committee and Board of ABC Federal Credit Union:

We have performed the procedures enumerated below, which were agreed to by the supervisory committee and Board of ABC Federal Credit Union, solely to assist you in connection with your supervisory audit of ABC Federal Credit Union conducted pursuant to §715 of the *National Credit Union Administration Rules & Regulations*. The procedures performed by us and enumerated in the attached supplement are in accordance with the minimum procedures described in Appendix A of the National Credit Union Administration's *Supervisory Committee Guide for Federal Credit Unions*. Because the committee is responsible to ensure that a complete set of procedures is performed and because Appendix A procedures are designed for smaller, less complex credit unions, we performed other procedures at the committee's request. This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the specified parties. Consequently, we make no representation regarding the sufficiency of the procedures described in the supplement either for the purpose for which this report has been requested or for any other purpose.

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of [the specified parties] and is not intended to be and should not be used by anyone other than these specified parties.

[Signature of Independent Auditor]
[City, State]
[Date]

References

- *Federal Credit Union Act*
 - 115 - Supervisory Committee
- *NCUA Rules and Regulations*
 - 715 - Supervisory Committee Audit
- *Supervisory Committee Guide*
- AICPA Audit and Accounting Guide (relevant to Credit Unions)

NON OPINION AUDITS – APPENDIX 5D

Non-Opinion Audit Conducted by the Committee or Its Non-CPA Designee

In an audit performed by the supervisory committee or its designee, the examiner looks for a critical and systematic examination of the internal controls, statements, records and accounting transactions prepared by management. Unlike an audit performed by a CPA, professional standards governing competence and independence do not govern this type of audit. Examiners use similar criteria for reviewing and evaluating non-CPA audits as for reviewing and evaluating a CPA's work.

An acceptable audit satisfies the requirements of *NCUA Rules and Regulations* §715.7 (c), Audit per Supervisory Committee Guide, in a particular credit union. An unacceptable audit does not meet the requirements. Exact acceptability standards for audits performed in credit unions do not exist. Examiners must judge the risk and exposure in each case to determine if an audit fulfilled the requirements of *NCUA Rules and Regulations* Part 715.

Examiners must use certain standards in reviewing supervisory committee work. Part 715 of the *NCUA Rules and Regulations*, the *Supervisory Committee Guide*, and the supervisory committee section of the *Examiner's Guide* contain information on these standards.

Appendix A, an important and key section of the *Supervisory Committee Guide*, sets forth the minimum procedures for performing a supervisory committee audit. Examiners should familiarize themselves with the caution expressed in the Foreword language to the Appendix. Also, as part of the review, the examiner should determine if the supervisory committee properly documented the completed audit procedures in working papers included in the audit or verification report (see Working Paper Access section.)

In some cases, minimum audit procedures remain inadequate because of the services or circumstances in a particular credit union. "High risk areas" (e.g., cash operations, share drafts, ATMs, or when a credit union experiences record keeping problems) may require expanding procedures.

Areas experiencing unusual activity or volume, or those containing recently added programs or requirements also may require expanding audit procedures. For example, unusual activity might include excessive amounts charged to officers' and directors' travel expenses for a specific period. Unusual volume might include a 30 percent loan to share ratio with the remainder of the assets invested. The first case might require an expansion of the expense review; the second might require an expansion of the investment review.

References

- *NCUA Rules and Regulations*
 - 715 - Supervisory Committee Audit
- *Supervisory Committee Guide*