

University Federal Credit Union
Austin, Texas
Comments on ANPR 7535-01-U, Supervisory Committee Audits

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

Dear Members of the Board,

Thank you for the opportunity to comment on 71 FR 9278 (Feb. 23, 2006), Advance Notice of Proposed Rulemaking, 7535-01-U, Supervisory Committee Audits. The proposed requirements in this ANPR represent a significant impact on cost and resources to credit unions, should these regulations be imposed. For many credit unions the additional burdens suggested could be overwhelming. NCUA should seriously question the value of these reporting requirements, and determine whether applications of one business environment, where there are valid reasons for implementation, is appropriate for the credit union environment, where those reasons do not exist.

NCUA's Letter to Federal Credit Unions 03-FCU-07 offered guidance on selected portions of the Sarbanes-Oxley Act (SOX). All credit unions, as a matter of due diligence should be required to review and respond to that guidance, and evaluate best practices within their own business model. However, the perceived benefits of imposing these reporting requirements on all credit unions in reaction to practices in other industries simply do not outweigh the costs.

The following are specific responses to questions posed in ANPR 7535-01-U.

- 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.*

No. NCUA currently has the powers it needs to evaluate credit union internal controls. NCUA has vast regulatory powers when issuing Documents of Resolution (DORs) or Letters of Understanding (LUAs). These could be used to require attestations on internal controls, on a case by case basis, without imposing an additional burden on the entire industry. Given NCUA's ability to obtain information it needs under current regulations, there should not be an imposition of additional reporting requirements.

NCUA cites arguments made by the U.S. General Accountability Office (GAO) that "NCUA may gain an evaluation of internal controls, comparable to other regulators". GAO contends the attestations on internal controls would enhance public confidence.¹ However, there is no evidence of any loss of public confidence in credit unions. There is no rash of malfeasance or corruption in the credit union industry, and there is no increased threat to NCUA's insurance fund.

¹ Issues Regarding the Tax-Exempt Status of Credit Unions (GAO-06-220T), November 3, 2005, page 4.

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Credit union financial statements are prepared for the benefit of its members. It is doubtful many credit union members peruse financial statements before applying for loans. And even more doubtful is members who contemplate the effectiveness of internal controls when depositing their paychecks. Even so, financial statements are audited under generally accepted auditing principals by CPAs, scrutinized periodically by NCUA examiners, and continually assessed by internal auditors. Further, an “alphabet soup” of regulations requires self-audits or independent reviews of various operations. If a credit union’s control environment is still in doubt after all that scrutiny, NCUA has in its power the ability to demand an attestation on internal controls. Any more reporting requirements would be a huge unnecessary burden.

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 reason for the threshold you favor.*

The purpose stated in the ANPR is to gain an evaluation of an institution’s internal controls, comparable to other depository institution regulators. Therefore, the minimum asset size threshold should be at least as large as the FDIC of \$1 billion, if not greater for the purposes stated above.

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

No. The minimum asset size threshold for corporate credit unions should be less. Corporate credit unions, by nature, have more complex balance sheet risk, and because their member base is other credit unions, they should be subject to higher standards.

4. *Should management’s assessments of the effectiveness of internal controls and 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?*

In most credit unions, the same internal controls over regulatory reporting (i.e., Call Reports) are in place over the preparation of financial statements prepared in accordance with GAAP. Therefore, assessments and attestations of the effectiveness of internal controls for financial statement purposes should be sufficient to evaluate industry internal controls comparable to other depository institution regulators.

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.

This issue should not be regulated. Supervisory Committees should have a choice as to whether they hire the same auditor for both engagements, or different auditors. There is no additional risk or benefit to either option, and there is no reason to regulate the issue.

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

Annually. Any less would create additional burdens of documenting and assessing new controls and systems. An annual requirement could be built upon using a prior year baseline, and coordinated in conjunction with the annual audit requirements, thereby minimizing the disruptiveness of the process.

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 was to be required by Part 715, the effective dates for compliance should be for fiscal periods beginning no sooner than 2 years after the final rule is in place. This proposed requirement is a tremendous burden, and could radically affect costs to many credit unions.

8. *If credit unions were required to obtain an “attestation on internal controls,” should part 715 require 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.*

Credit unions are not publicly held companies, and therefore, should obtain attestations which adhere to the AICPA’s AT 501 standard.

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.*

No. While COSO is widely recognized, NCUA should not mandate COSO’s Internal Control – Integrated Framework. Portions the COSO framework are relevant to all business environments, but credit unions, with NCUA approval, should have an option of choosing the standard most relevant to their business model.

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*

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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?

Yes. The imposition of minimum levels of expertise would be of more added value than an attestation on the effectiveness of internal controls. However, credit union or banking expertise should not be the only option available. In lieu of credit union or banking experience, Committee members should have experience with auditing or financial statements. Minimum asset size should be \$500 million.

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?

Yes. All Supervisory Committees should have access to outside counsel, when the Committees believe they need outside counsel. Retaining outside counsel should be a Committee decision, but the imposition of available budgetary funds should be mandated with no minimum asset size threshold.

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. This is a nebulous idea. What is a “large customer”? Few, if any credit unions have large customers. Credit unions of a substantial size have so many members, individual volunteers have little influence over the membership at-large. Self-dealing and conflicts of interest should be directed in ethics policies established by the Board of Directors.

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 with each qualification.

Credit unions smaller than \$500 may have difficulty recruiting volunteers with minimum levels of financial or banking expertise. The number of potential volunteers may be limited, depending of the fields of membership of small organizations.

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?

Independence standards should meet those defined by the AICPA. The SEC’s independence requirements pertain to publicly held companies, and therefore do not apply to member-owned credit unions.

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?*

No. Independent audits of full financial statements are available at reasonable costs for all credit unions. Balance sheet audits are obsolete.

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. There is value in retaining this audit, but the asset size to which it applies should be reduced to \$50 million or less. Independent audits of financial statements are available for reasonable costs to all credit unions. Small credit union Supervisory Committees still benefit from a “cookbook” approach to the annual audit requirements.

17. *Should Part 715 require credit unions that obtain a financial statement audit and/or and “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?*

No. Part 715 contains verbiage requiring Supervisory Committees to provide copies of audit reports to NCUA. As a matter of course, NCUA examiners are provided copies of any documents at the time of the periodic exam. Further regulation is unnecessary, and would simply lead to a large collection of documents at NCUA that were never reviewed.

18. *Should Part 715 require credit unions to provide NCUA with a copy of the 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?*

No. Part 715 contains verbiage requiring Supervisory Committees to provide copies of audit reports to NCUA. As a matter of course, NCUA examiners are provided copies of any documents at the time of the periodic exam. Further regulation is unnecessary, and would simply lead to a large collection of documents at NCUA that were never reviewed.

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?*

No. Part 715 contains verbiage covering Supervisory Committee responsibility over audits. Whether or not credit unions are to forward reports to NCUA, the Committee should and does review those reports as part of its responsibility to deliver an audit.

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*

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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?

No. Part 715 should not be amended regarding this issue. 120 day is sufficient to deliver an audit report, but shortening this time frame could make it difficult, given most credit unions are on a calendar year basis which coincides with most public companies. Therefore, external audit firms are extremely busy during this time frame. Any sanctions for failing to include the delivery date should be imposed on a case by case basis.

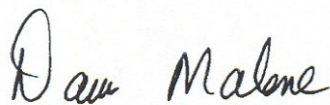
21. Should Part 715 require credit unions to notify NCUA in writing whether they enter into an engagement with an auditor, and/or when an engagement ceases by reason of the auditor's dismissal or resignation? If so in cases of dismissal or resignation, should the credit union be required to include reasons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

No. Part 715 should not address this issue. Information and documentation regarding audit engagements or dismissals are available to NCUA examiners. Written notification to NCUA would serve no purpose, and would impose unnecessary reporting requirements.

22. 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 liabilities?

Yes. Supervisory Committees should be prohibited from waiving any auditor liability. NCUA should look to AICPA audit standards and guidance in establishing minimum audit standards for Supervisory Committees.

Again, on behalf of the Supervisory Committee, we thank you for the opportunity to comment to these proposed rules.



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