

April 17, 2006

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

RE: Advance Notice of Proposed Rulemaking – Parts 704, 715, and 741

Dear Ms. Rupp:

This letter is in response to the National Credit Union Administration's (NCUA) request for comment on the above referenced Advance Notice of Proposed Rulemaking (ANPR).

Educational Employees Credit Union (EECU) is a state chartered, federally insured credit union in Fresno, CA with assets of approximately \$1.3 billion at March 31, 2006. It was founded in 1934 and currently has over 136,700 members. EECU's field of membership is open to employees and students, and immediate household and family members of same, of any licensed school, community college, or university system in a ten county area of California's Central Valley.

We understand and can appreciate the NCUA's and GAO's apparent concern over the integrity and transparency of financial reporting. However, EECU opposes the proposed changes to the existing supervisory committee audit rules, including an attestation on the internal controls over financial reporting, for several reasons. We believe they equate to regulatory overkill, are costly and burdensome, and most importantly, do not offer any increased value to our members with regard to the safety and soundness of the organization.

In preparing our response to the ANPR, we contemplated what benefits the proposed oversight offers our membership and the National Credit Union Share Insurance Fund while considering the costs to implement the proposed rules, as well as the extent of current regulatory scrutiny. In addition, we considered the potential impact on the unique nature of the credit union industry, especially with regard to implementing more "bank-like" (FDICIA) regulation, and SOX 404 type regulation that was intended to address the dramatic failures of public companies such as Enron and WorldCom.

We submit the following comments to questions addressed in the ANPR for your consideration.

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

The purpose of NCUA's proposal for an attestation of internal controls over financial reporting is to enhance their oversight of credit unions by creating parity with other financial institutions' financial reporting requirements. This enhanced oversight does not appear necessary. As concluded in "*Credit Union Failures and Insurance Fund Losses: 1971 – 2004*," from the FRBSF's Economic Letter dated August 19, 2005, ". . . failure rates have typically been lower for larger credit unions than for smaller credit unions and lower for credit

unions than for commercial banks of similar size.” Clearly, the proposed rules for enhanced oversight do not fit credit unions.

The reliance placed on financial statements from credit unions and those from public companies is fundamentally dissimilar. The financial statements of a credit union are of importance only to that credit union’s membership, not to the investment community.

Discussion with peers and accounting professionals indicate that implementation costs of the proposed rule are estimated at \$300,000 to \$400,000 for the first year, with a minimal reduction in cost in subsequent years. Using 12/31/05 figures, the cost of implementation at EECU would negatively impact our ROA by 2 to 3 basis points, thus potentially limiting the products and services offered to our members. (In light of the changing economy, and the narrowing spreads, the impact may be even greater at 12/31/06.) In the alternate, the cost of compliance could be passed on to the membership by lower dividend rates and/or higher interest rates on loans. Again, this is of no benefit to the membership.

Another effect the proposed rule would have is that the time spent on implementing the proposed rules may result in less time being spent on the business at hand. Projects and initiatives from the Board, designed to benefit the membership, may be deferred to after implementation due to the availability of staff and other assets.

EECU, as do all other credit unions, exists to **serve our members and to give them something back**. The credit union charter is inherently less risky than are the charters for state or federal banks and savings and loan associations with regard to “cooking the books.” There simply is little to no financial incentive for credit union management to intentionally misstate its financial statements. The earnings of a credit union are returned to ALL members (account holders) of the credit union in the form of lower loan rates, higher dividends on deposits, and lower fees, whereas the earnings of a publicly traded company are returned to stockholders (many who are not even account holders of the financial institution).

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

Keeping in mind that we do not believe additional regulatory oversight is necessary, we submit the NCUA might consider requiring a credit union to provide an attestation on internal controls over financial reporting based on its performance rather than its asset size. For example, should a credit union receive less than a CAMEL 2 rating, a remediation plan that would include a review of the internal controls over financial reporting might be appropriate.

- 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.**

While we do not believe the credit union should provide an attestation of the internal controls over financial reporting, we believe that natural person credit unions and corporate credit unions should have the same threshold.

- 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?**

While we do not believe the credit union should provide an attestation of the internal controls over financial reporting, we believe that management's assessment should cover financial reporting for regulatory purposes only (i.e., the call report) because the financial statements of a credit union are not used by individuals and/or entities for investing purposes.

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

While we do not believe the credit union should provide an attestation of the internal controls over financial reporting, we believe that the same auditor should be permitted to perform both the financial statement audit and the "attestation on internal controls" over financial reporting. Engaging the same auditor to perform both audits would reduce audit costs because the external auditor performing the financial statement audit already has an understanding of the credit union's internal control environment.

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

While we do not believe the credit union should provide an attestation of the internal controls over financial reporting, we believe that less frequently than annually would be sufficient if there were no significant changes to management, products, delivery avenues, etc. Significant changes would require an attestation on those matters.

- 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)?**

While we do not believe the credit union should provide an attestation of the internal controls over financial reporting, we believe that an effective date of no sooner than two fiscal years after publication of the final rule in the Federal Register would be reasonable. This would allow credit unions adequate time to plan, implement, remedy, and document the assessment and attestation.

- 8. If credit unions were required to obtain an "attestation on internal controls," should part 715 require those attestations, whether for a natural 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.**

While we do not believe the credit union should obtain an attestation of the internal controls over financial reporting, we believe that, because credit unions are not public companies, they should not be required to adhere to PCAOB's AS 2, but should follow the AICPA's revised AT 501 standards.

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?

While we do not believe the credit union should provide an assessment of the internal controls over financial reporting, we believe that COSO should be the standard used for assessing the effectiveness of the credit union's internal control structure.

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

Yes. Even though the Supervisory Committee members are volunteers, they must have a minimum understanding of financial matters in order to fulfill their fiduciary responsibility. To that end, Supervisory Committee members should be required to complete basic courses offered through CUNA, or some other group, that are appropriate to the size and complexity of the credit union. All Supervisory Committee members, regardless of the assets of a credit union should, at a minimum, complete training on financial statement analysis and internal control systems.

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

No. In California, Supervisory Committees of state chartered, federally insured credit unions already have the authority to engage additional audits as deemed necessary. The California Financial Code already states the following:

“S. 14551.5: The supervisory committee shall be responsible for reviewing the credit union's policies and control procedures to safeguard against fraud and self-dealing, and the supervisory committee shall exercise whatever efforts are necessary pursuant to Sections 14551 and 14553 to meet those responsibilities.”

and

“S. 14553(b): The supervisory committee may make or cause to be made any supplementary inspections of the securities, cash, and accounts of the credit union or audits as it deems necessary, and submit reports of those audits to the board of directors.”

Requiring volunteers to have access to their own outside counsel may make it harder to recruit competent members to serve as this component would likely raise their concerns regarding personal liability. That said, credit unions would face another hidden cost based

on rising insurance premiums as many would need to re-evaluate their coverage limits for director's liability.

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 that minimum asset size threshold?

No. An executed, comprehensive Business Code of Conduct should prohibit conflicts of interest.

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.

Quite possibly. Because credit union volunteers come from its membership, it is possible that some FOMs may not have members as experienced in financial matters that the rule proposes.

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?

While we do not believe the credit union should obtain an attestation of the internal controls over financial reporting, we believe that, because credit unions are not public companies, the auditor should be required to meet only the AICPA's independence standards, and not the SEC's "independence" requirements.

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

Yes, there is value in retaining the existing "balance sheet audit" rule as an audit option for credit unions with less than \$500 million in assets.

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 the existing "Supervisory Committee Guide" as an audit option for credit unions with less than \$500 million in assets.

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

No. While we do not believe the credit union should obtain an attestation of the internal controls over financial reporting, we believe, that as are all other auditor's reports, an attestation should be available to the regulators in conjunction with the on-site examination.

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?

No. This information is currently made available to the regulators in conjunction with the on-site examination.

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

Yes. While we do not believe the credit union should provide an attestation of the internal controls over financial reporting, we believe that in all cases, the external auditor should review any and all reports 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 delivery date within its engagement letter?

The requirement of a credit union's engagement letter to indicate a target date of 120 days after the audit period-end for delivery of the audit report remains reasonable. However, the feasibility of the external auditor's delivery of the audit report within this timeframe is unknown at this time. Should the proposed rule be adopted in whole or in part, external auditors may be challenged to hire and train additional qualified staff to meet the newly increased demand for attestation audits. Further, the target delivery date of the audit report may not be met due to scheduling conflicts resulting from additional field work.

With regard to what sanctions should be imposed for failure to include a target delivery date in the engagement letter, we believe, at worst, that the Supervisory Committee could face criticism from the regulator under the management component of the examination.

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?

No. These are responsibilities of the Supervisory Committee, Board and management. These documents are available to the regulators in conjunction with the on-site examination.

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

Yes to both questions. Supervisory Committees, acting in a fiduciary capacity on behalf of the members, should not be given the latitude to waive or limit the auditor's liability. If prohibited, but still done by the committee, the NCUA would have the latitude to criticize the committee's actions under the management component of the examination.

Thank you for the opportunity to respond to this very important issue. We appreciate your consideration of our comments.

Sincerely,

A handwritten signature in black ink that reads "Bruce Barnett". The signature is written in a cursive style with a long horizontal stroke extending from the end of the name.

Bruce L. Barnett
President/CEO

cc: EECU Board Chair
EECU Supervisory Committee Chair
DFI
McGladrey