



OSU Federal
Your Community Credit Union™

April 20, 2006

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

RE: Comments on Advanced Notice of Proposed Rulemaking on Supervisory Committee Audits

Thank you for the opportunity to comment on this advanced notice of proposed rulemaking. We appreciate the desired to discuss the impact of this topic prior to drafting a proposed rule.

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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?
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No. The premise that the credit union sector will be inherently safer with an attestation on internal controls audit has not been fully scrutinized and less costly alternatives have not been proposed.

An attestation on internal controls was only a part of the government’s solution to the wholesale collapse of the savings and loan industry during the 1980’s. The Federal Deposit Insurance Corp. Improvement Act of 1991 (FDICIA), which reformed banking regulation contained other measures, such as Prompt Corrective Action (PCA), [which NCUA adopted following the passage of CUMMA], a risk based premium system for FDIC administered deposit insurance, and “least cost” failure resolution.

It should be significant that Congress did not extend FDICIA to NCUA and the NCUSIF. An integral part of the reason is inherent in the structure of credit unions as mutually owned cooperatives. Credit unions are fundamentally different from the banking industry, which is primarily based on the stock ownership model. The motivations and incentives to falsify financial statements to drive stock price, attract investors, or enrich executives through such actions do not exist within the credit union movement.

The revelations of corporate greed and financial statement falsification in major companies such as Enron, Worldcom, and Tyco resulted in the Sarbanes-Oxley Act of 2002. The complicity and failure of the now defunct CPA firm Arthur Anderson tainted the public accounting profession. It is not surprising steps would be taken to address a proven problem and restore the public’s trust. Creation of the Public Company Accounting Oversight Board and giving the SEC more enforcement powers makes sense within the context of what happened.

What does not make sense is saying that because the bank industry required FDICIA and the corporate world required Sarbanes-Oxley, both of those now must be extended to the credit union environment in the form of an attestation on internal controls.

The requirement of an attestation on internal controls for public companies was initiated with the adoption of Sarbanes Oxley. The impetus for its adoption was the need to provide assurance to average small investors that the financial reports of the company in which the investor owns stock is accurate. As noted, there is often a significant incentive for management of public companies to improve their financial position reflected in the published financial statements.

Even today, Sarbanes-Oxley's section 404 has not been fully implemented with the large accelerated filers just recently complying for the first time since 2002. In addition, there have already been proposals to significantly revise the requirements and include additional limitations for complying with this regulation. There is no information that can substantiate that compliance with 404 has actually improved the quality of financial statements or the assurance to investors.

What has happened within the credit union industry that would suggest the current level of audit is not adequate? Have there been significant issues with financial reporting fraud within the credit union industry? Have individual credit union members or "investors" experienced significant loss due to financial reporting fraud? What other alternatives exist which can be utilized to ensure adequacy of internal controls?

These are not just rhetorical questions. They demand serious investigation before any proposal is put forth about mandating an attestation on internal controls.

NCUA needs to understand a proposal to require an attestation on internal controls sets in motion a very expensive process for those credit unions which fall under the requirement to comply. A mandated proposal by the regulator usurps management's prerogative of choosing an action based on cost/benefit analysis. In essence the regulator will be making a decision that will cost the members of the credit union significant expense both in terms of direct dollars and lost opportunity cost. Furthermore, without offsetting revenue or passing costs along to the membership it is hard to envision this having anything but a negative effect on capital.

NCUA has a solid track record of supervising and regulating federally credit unions and administering the NCUSIF in a sound manner. Does NCUA wish to be put in the position of mandating a huge expense that likely will have minimal or no perceived value by the majority of credit union members and contributes to a possible erosion of a credit union's capital.

Credit Unions are currently held to a high level of scrutiny by regulators. In fact, Chairman Johnson testified last November before the Financial Services Committee that there is a need to reduce the "oppressive regulatory burden facing credit unions," the implementation of this requirement would appear to be in direct opposition to that stance and would severely increase the burden on credit unions.

In summary, it is highly questionable the high cost of compliance would add value to either the membership of credit unions, or NCUA. In fact, pulling resources away from value-adding services for members would actually result in a loss of value to members.

If NCUA decides to proceed and require an attestation on internal controls, we urge a delay until Sarbanes-Oxley's section 404 has been fully implemented and the results evaluated.

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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?
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The minimum size should be at least the \$1 billion level required by FDICIA. We are quite skeptical about the value of this applied to a credit union of any asset size. This is because of the fundamental credit union structure.

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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?
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Probably not, since corporate credit unions only have natural person credit unions as members, and no individual members. Natural person credit unions that invest in corporate credit unions are more sophisticated and have the resources that a small individual investor may not, to scrutinize financial data and recognize the potential for weaknesses in internal controls. Therefore, the need for additional oversight is lessened for corporate credit unions.

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4. Should the 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 purposes), or should it be more narrowly framed to cover only certain types of financial reporting?
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If required, management's assessments and external auditor attestation should only cover regulatory reporting, which is what shareholders have access to.

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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?"
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Yes, a single auditor should be permissible for both engagements, because there's likelihood of cost savings when these functions are combined (economies of scale). Yet, if best practices and prices dictate otherwise, separate engagements should be permitted.

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6. If an "attestation on internal controls" were required of credit unions, should it be required annually or less frequently?
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Because the incentive for fraud is much lower for credit unions and annual attestation is burdensome, a less frequent cycle would be adequate. Unless there are significant product or process changes, an attestation more frequent than every 3 years would not provide additional value.

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7. If an "attestation on internal controls" were required of credit unions, when should the requirement become effective?
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It remains to be seen if the desired results of the Sarbanes-Oxley Act will be achieved, and its deadline for implementation has been pushed back to nearly 4 years for just the accelerated filers. It is recommended that NCUA wait until the Sarbanes-Oxley Act is fully implemented, then subsequently, a reasonably long period should be provided for qualifying filers to prepare for implementation.

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8. If credit unions were required to obtain an "attestation on internal controls," should part 715 require that those attestations, whether for a natural person or a corporate credit union, adhere to the PCAOB's AS2 standard that applies to public companies, or to the AICPA's revised AT 501 standard that applies to non-public companies?
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The AICPA's standard for non-public companies would be more appropriate for natural person and corporate credit unions. However, we note the AICPA is moving towards the PCAOB's standard. We question the wisdom of that move. There is a very clear fundamental difference between a stock based and a cooperatively based capital structure.

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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?
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The standard used by a credit union's management should not be mandated by NCUA, but mutually agreed upon by each individual credit union's management, internal audit staff and external auditor, and include attributes acceptable to NCUA. While COSO is widely accepted, a standard was not mandated in the Sarbanes-Oxley Act, and mandating a standard would preclude the movement to an improved framework that might emerge in the future.

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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?
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While asset size may seem like the most logical threshold to use, restricted field-of-membership credit unions may find it particularly difficult to find committee members meeting this criteria, since these are unpaid volunteer positions. Although there is value in having experienced Supervisory Committee members, asset size won't preclude that. Additionally, complexity and nature of services operations need to be considered.

This is also one of those areas where NCUA needs to analyze its records of failed credit unions to determine if or how experience or expertise of supervisory committee members would have made a difference. Ironically, the agency might find the expertise was needed at smaller asset sizes rather than larger.

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?

Supervisory Committee members of any size credit union should not be required to have their own outside counsel, yet should have access to legal counsel when needed. Supervisory Committees' should always have resources available to them in order to carry out their duties as expressed in the FCU Act and Bylaws.

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, because they are not paid and have minimal incentive for personal gain. What damage has been done in the past to warrant such a mandate? Also, the enforcement would be difficult to implement and monitor.

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 associated with each qualification.

Yes (see #10 above).

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?

Refer to answer for #8 above. Furthermore, we strongly urge NCUA to recognize the SEC regulates public companies. Credit unions are not public companies.

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

Retaining this as a choice is important for smaller Credit Unions.

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, but this audit option could be reduced to credit unions with less than \$100 million in assets. We recommend this because the substance of the Guide seems more applicable to audits of credit unions of that size. The Guide is an excellent resource for Supervisory Committees regardless of size, however.

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 the NCUA routinely uses them for review prior to exams, providing them a copy would not be a hardship. If they are not utilized effectively, they should just be made available in conjunction with the on-site exam. The period should at least be parallel to the current requirement of 120 days, if not extended as suggested in #20.

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?

Our response is the same as #17 above.

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?

The Supervisory Committee should always have the opportunity to review external auditors' findings before they are submitted to NCUA.

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?

If the target date for delivery were extended to 180 days after the audit period-end, from the present 120 days, many credit unions would likely be able to negotiate lower audit fees, especially with audits on a calendar year cycle. Sanctions against credit unions failing to include the target delivery date in their engagement letters, should be determined on a case-by-case basis.

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 resignations?

Credit unions should not be required to notify NCUA of each engagement, or termination thereof, unless a termination occurs outside the normal terms of the original engagement.

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?

Regulation is not required. The advisory should be sufficient. This is in keeping with reducing the regulatory burden as much as possible. Examiners retain authority to cite the advisory as a basis for a DOR item.

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