

**YOUNG, SHERON**

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**From:** \_Regulatory Comments  
**Sent:** Monday, April 24, 2006 10:04 AM  
**To:** YOUNG, SHERON  
**Subject:** FW: SUPERVISORY COMMITTEE AUDITS - ADVANCE NOTICE OF PROPOSED RULEMAKING

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**From:** John McKenzie [mailto:JohnM@icul.org]  
**Sent:** Friday, April 21, 2006 3:37 PM  
**To:** \_Regulatory Comments  
**Subject:** SUPERVISORY COMMITTEE AUDITS - ADVANCE NOTICE OF PROPOSED RULEMAKING

April 21, 2006

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

Re: Supervisory Committee Audits - Advance Notice of Proposed Rulemaking

Dear Ms. Rupp:

The Indiana Credit Union League appreciates the opportunity to comment on the NCUA Supervisory Committee Audits - Advance Notice of Proposed Rulemaking (ANPR). Supervisory Committees have a vital role in the operations of credit unions and in the verification of the ongoing compliance of credit unions' policies and procedures pertaining to specific objectives contained in Part 715 of *NCUA Rules and Regulations*. We appreciate NCUA requesting input prior to issuing a proposed rule that impacts this important group of volunteers.

The importance of accurate and transparent financial statements and financial reporting is of utmost importance in today's business environment. While the proposals outlined in the ANPR are intended to accomplish this accuracy and transparency, we think that they are unnecessary. The existing regulations in Part 715 of *NCUA Rules and Regulations* are designed to provide accurate and transparent credit union reporting and are appropriate given the differences between credit unions and for-profit financial institutions or stock-based companies.

Sarbanes-Oxley (SOX) is an attempt to protect the shareholders of publicly traded companies because of losses suffered in the past through management manipulation of financial statements to meet shareholder or market expectations. Credit unions are not-for-profit, are not public companies, do not issue stock, do not have access to capital markets and lack the exotic accounting issues and incentives for influencing stock prices.

The cost of complying with the "attestation on internal controls" has been very costly for public

4/25/2006

companies. Not just the cost of the “attestation” by an external auditor, but also the significant cost of staff time necessary to develop the “attestation” for auditor review. These costs have been estimated at hundreds of thousands of dollars for some corporations. If credit unions were forced to comply with and incur the “attestation” costs, the expense impact would ultimately be borne by the member-owners. There does not appear to be enough new benefits in these proposals to offset the additional costs.

We do not see any significant improvements to regulatory oversight from the proposals in the ANPR. Credit unions are already subject to frequent regulatory scrutiny through the multitude of regulations they must comply with, examinations by regulators, and quarterly financial reporting. There also exists an additional layer of loss protection for the members in the share insurance coverage all credit unions carry.

The following are responses to the specific questions listed in the ANPR:

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?

**No. We think that the Part 715 is adequate to ensure accurate and transparent financial reporting by credit unions and that an “attestation on internal controls” is not necessary. This additional requirement would be costly to credit unions and would not result in any significant improvements over the current regulations to warrant the added expense.**

2. What minimum 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? Please explain the reasons for the threshold you favor.

**While we strongly believe that this should not be applied at all, should NCUA decide to add this requirement, a minimum threshold of \$1 billion in assets should be applied. We would also be in favor of setting this threshold even higher given the differences between credit unions and for-profit financial institutions.**

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?

**No. The intent of SOX was to protect individuals who lack adequate access or resources to become aware of or recognize potential for fraud resulting from mismanagement of the accounts and financial statements of a company. Since individuals are not members of corporate credit unions, an argument could be made that this should not apply to corporates at all, or that a much higher asset size threshold for corporates be established.**

4. Should management’s assessments of the effectiveness of internal controls and the attestation by its external auditor cover all financial reporting -- financial statements prepared in accordance with generally accepted accounting principles (GAAP) and those prepared for regulatory reporting purposes - - or should it be more narrowly framed to cover only certain types of financial reporting? Please explain. If you believe it should be narrowly tailored, which types of financial reporting should be covered?

**All financial reporting. Given the close relationship between the GAAP financial statements and those prepared for regulatory reporting, it would make sense for any proposals to govern all financial reporting.**

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?”

**A credit union should have the flexibility to utilize the same auditor for both the financial audit and the “attestation” in order to maximize the efficiency of the process and to reduce expenses associated with it. Should the credit union decide to hire different auditors for each audit, they should have that option as well.**

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

**Should the “attestation on internal controls” be required, we do not think that it should be required annually.**

7. If an “attestation on internal controls” were required of credit unions, when should the requirement become effective (in the fiscal period beginning after December 15 of what year)?

**We think at least two years after all the requirements are finalized will be needed for credit unions to put in to place the necessary staff and processes to develop an initial “attestation on internal controls.” For many credit unions additional staff will be required to develop and manage this process effectively going forward.**

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 corporate credit union, adhere to the Public Company Accounting Oversight Board’s (PCAOB’s) AS2 standard that applies to public companies, or to the AICPA’s revised AT 501 standard that applies to non-public companies?

**Since credit unions are not public companies, the revised AT 501 standard that would apply to non-public companies would appear to be more applicable to credit unions.**

9. Should NCUA mandate the Committee of Sponsoring Organizations of the Treadway Commission’s (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?

**If NCUA decides to require an “attestation” some standard should be developed that would be applied in order to maintain consistency in the expectations of the regulator. Rather than trying to make a standard developed for public companies or companies with significantly different operations than credit unions, NCUA should develop a standard that is a better fit for credit unions.**

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?

**Establishing minimum levels of experience or expertise for Supervisory Committee members is difficult given the variations in the fields of membership credit unions have available to draw from for volunteers. Of course, it would be very beneficial for at least one**

**member of the Supervisory Committee to have some financial institution, accounting, or financial management experience. However, what skills a committee member may need varies somewhat depending on whether the auditing function is outsourced, or if there is an internal auditing department at the credit union that they must work with. As a credit union grows in size and complexity, additional skills may be required of committee members as well. Will additional skill sets be required by regulation? Does the credit union have the skill sets required within the limited field of membership from which they are drawing volunteers? We do not think this is an area that should be addressed in regulations.**

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? Yes\_\_\_\_ No\_\_\_\_

If no, why not? If yes, at what minimum size threshold should the Supervisory Committee members have that right?

**This is not something that should be required by regulation. In practice, Supervisory Committee members should have option of obtaining outside counsel if it is needed, and the credit union could develop policies that address at what expense levels Board approval would be required.**

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? Yes\_\_\_\_ No\_\_\_\_ If no, why not? If yes, at what minimum asset size threshold should the prohibition kick in?

**We do not think this is necessary. The term “large customer” does not have the same meaning for credit unions as it does for other financial institutions. By regulating this, certain members could be “prohibited” from participating fully in the credit union as a volunteer depending on the definitions applied. There needs to remain the expectation of independence from influence and the avoidance of conflicts of interest with any members, vendors or credit union employees.**

13. If any of the potential qualifications mentioned in the questions above were required of Supervisory Committee members, would credit unions have difficulty in recruiting and retaining competent individuals to serve in sufficient numbers? Yes\_\_\_\_ No\_\_\_\_

If yes, what would those obstacles be?

**Potentially any additional requirements proposed in question 10 could make it more difficult for credit unions to find individuals willing to volunteer to serve. Any specific experience or knowledge requirements will reduce the number of members eligible to serve.**

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? Please explain.

**The auditor should meet the AICPA independence standards. Credit unions are not regulated by the SEC.**

15. Is there value in retaining the “balance sheet” audit in Section 715.7(a) of NCUA’s rules as an audit option for credit unions with less than \$500 million in assets?

**Yes. Smaller credit unions should continue to have the various options for audits that are available to them today.**

16. Is there value in retaining the “Supervisory Committee Guide audit” in Section 715.7(c) of NCUA’s rules as an audit option for credit unions with less than \$500 million in assets? Yes\_\_\_ No\_\_\_ Please explain.

**Yes. Smaller credit unions should continue to have the various options for audits that are available to them today.**

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? Yes\_\_\_ No\_\_\_ If yes, how soon after the audit-period end? If not, why not?

**Copies of any audit reports and work papers are to be made available to the examiner as part of the regular examination. The results from any additional audit requirements could be handled the same way.**

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? Yes\_\_\_ No\_\_\_ If not, why not? If yes, how soon after the credit union receives the report should the credit union have to provide a copy to NCUA?

**All items listed in the question above are readily available to the examiner during the regular examination process. This should continue to be the primary method for examiners to receive this information.**

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\_\_\_ No\_\_\_ Please explain.

**Yes. The Supervisory Committee, at a minimum, should have the opportunity to review any information from audits prior to that information being shared with any outside organizations including NCUA. This provides the opportunity for any audit findings that are the result of misunderstanding of processes and procedures to be addressed before the report is finalized.**

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? Please explain.

**The current target of 120 days is reasonable.**

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? Yes\_\_\_ No\_\_\_ If no, why not? If yes, in cases of dismissal or resignation, should the

credit union be required to include reasons for the dismissal or resignation?

**This information is readily available to the examiner during the regular examination process. This should continue to be the primary method for examiners to receive this information.**

22. NCUA recently published a joint Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters. 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? Please explain your views.

**We support NCUA prohibiting a credit union from signing an engagement letter that limits various forms of auditor liability. However, we also support credit unions having the option of waiving punitive damages. The auditor is still liable for actual damages which can be significant in amount.**

Thank you for the opportunity to comment on these proposed changes. If you or other NCUA officials have any questions about our comments, please feel free to contact me.

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