



March 20, 2006

Supervisory Committee Audits – Advance Notice of Proposed Rulemaking

EXECUTIVE SUMMARY

- NCUA has issued an Advance Notice of Proposed Rulemaking (ANPR) seeking input on whether NCUA should modify its Supervisory Committee Audit Rules, and if so, how. An ANPR does not reflect a specific proposal but rather requests comments on issues and concerns raised by an agency. If NCUA were to pursue this issue, the next step would likely be a proposed rule.
- The Credit Union Membership Access Act (CUMAA) and Part 715 of NCUA's Rules (Supervisory Committee Audits and Verifications), amended to conform with CUMAA, mandate that credit unions with \$500 million or more in assets obtain a financial statement audit on an annual basis. One of the specific issues NCUA is raising is whether credit unions should be required to secure an "attestation on internal controls" in connection with their annual audits. An "attestation on internal controls" consists of two parts. First, management must report its assessments of the effectiveness of the credit union's internal control structures and procedures. Second, the credit union's external auditor must examine, attest to (certify), and report separately on management's written report. The scope of the attestation could be limited only to the effectiveness of internal controls over financial statements prepared for regulatory purposes (such as the "report on examination of internal controls over Call Reporting" audit option available to credit unions under \$500 million in assets) or extended to include all financial reporting.
- In addition, the ANPR seeks input on specific issues including whether the audit options currently available to credit unions with less than \$500 million in assets should be retained.
- In the ANPR, NCUA is also requesting input on qualifications for serving on a credit union's Supervisory Audit Committee.

- Comments are due to NCUA by April 24, 2006. **Please send your comments to CUNA by April 17, 2006.** Please feel free to fax your responses to CUNA at 202-638-7052; e-mail them to Associate General Counsel Mary Dunn at mdunn@cuna.com or to Senior Regulatory Counsel Catherine Orr at corr@cuna.com; or mail them to Mary or Catherine in c/o CUNA's Regulatory Advocacy Department, 601 Pennsylvania Avenue, NW, 6th Floor - South Building, Washington, DC 20004. You may also contact us at 800-356-9655, ext. 6743, if you would like a copy of the proposal, or you may access it [here](#).

BACKGROUND

- There is no statutory directive in CUMAA, Sarbanes-Oxley or other statute that requires changes of the nature NCUA is seeking comments on. The ANPR was issued following a report in 2005 by the Government Accountability Office (GAO) (reiterating a recommendation it made in 2003) that recommended that large credit unions, as banks are required to do, should obtain an "attestation on internal controls" over financial reporting in connection with their annual financial statement audits.
- NCUA has been working on this since the release of the GAO report. However, they felt that at the time the GAO report was issued, the standards governing internal control assessments and attestations for non-public companies did not fit credit unions. Recently, however the American Institute of Certified Public Accountants (AICPA) has decided to revise those standards (AT 501) and NCUA is working with the AICPA on changes that they believe may be more useful to financial institutions, including credit unions. This development reinforced NCUA's decision to issue the ANPR for comments. CUNA's Comment Call on the AICPA's Proposed Statement on Standards for Attestation Engagements -- Reporting on an Entity's Internal Control Over Financial Reporting -- is available [here](#).

DISCUSSION

In this ANPR, NCUA specifically seeks comment on the following issues:

- Should credit unions be required to obtain an external auditor's "attestation on internal controls" in connection with their annual audits?
- What standards that should govern the assessment and attestation components of such audit engagement?
- What minimum qualifications should be required to serve on a Supervisory Committee? Currently, NCUA's regulations state that the Committee must consist of three to five members, none of whom may be a director other than the compensated officer of the board. Credit committee members and credit union employees are prohibited from serving on the Supervisory Committee. There is no minimum experience/expertise level required by the agency's regulations.

- Under Part 715, a financial statement must be “performed in accordance with GAAS [generally accepted auditing standards] by an independent person who is [State-licensed].” GAAS incorporates the “independence” standards established by the American Institute of Certified Public Accountants (AICPA). Should state-licensed, compensated auditors performing credit union audits be obligated to adhere to other/additional “independence” standards?
- Part 715 provides that credit unions with less than \$500 million in assets may choose among the four audit options: (1) a financial statement audit; (2) a “balance sheet” audit; (3) a “report on examination of internal controls over Call Reporting”; and (4) an audit as prescribed in NCUA’s Supervisory Committee Guide. Is there value in retaining these options?

QUESTIONS REGARDING THE ADVANCE NOTICE OF PROPOSED RULEMAKING

*In your responses, please answer with as much detail (and quantify the burden with as much specificity) as possible.

Internal Control Assessment and Attestation

The Sarbanes-Oxley Act requires all public companies, in connection with an annual financial statement audit, to obtain and “attestation on internal controls” over financial reporting. A 2005 GAO report recommended “making credit unions with assets of \$500 million or more subject to the Federal Deposit Insurance Corporation Improvements Act (FDICIA) requirement that management and external auditors report on the internal control structure and procedures for financial reporting....” Since the GAO report was released, the Federal Deposit Insurance Corporation (FDIC) has increased the minimum asset size of the institutions required by FDICIA to obtain an “attestation on internal controls” over all financial reporting from \$500 million to \$1 billion.

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?

Yes _____ No _____

Please explain why or why not.

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.

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

Yes ____ No ____

Why or why not?

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?

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 in one auditor to perform the financial statement audit and another to perform the “attestation on internal controls?”

Please explain.

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

Please explain.

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)?

Standards Governing Internal Control Assessments and Attestations

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? The AS2 standard can be found at http://pcaobus.com/Rules/Rules_of_the_Board/Auditing_Standard_2.pdf.

Please explain your preference.

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? A good overview of the COSO

standard may be obtained at
http://www.findarticles.com/p/articles/mi_m4153/is_5_60/ai_110222002#continue.

Please explain your preference.

Qualifications of Supervisory Committee Members

As a comparison, for banks with total assets of \$1 billion or more, the FDIC requires the audit committee (analogous to the Supervisory Committee of a credit union) to be composed completely of members who are independent of management of the institution. For banks with between \$500 and \$1 billion, the majority of the members of the audit committee must be independent of management of the institution. For banks with total assets of more than \$3 billion, audit committee members must: have banking/financial management expertise; access to their own outside counsel; and no association with any large customer of the bank.

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?

Yes____ No____

If no, why not? If yes, what criteria should they be required to meet? What should the minimum asset size threshold be?

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?

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?

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?

Independence of State-Licensed, Compensated Auditors

FDIC requires independent accountant who audit institutions with assets of \$500 million or more to not only meet the AICPA's Code of Professional conduct (AU §220 – Independence in AICPA *Professional Standards* at <http://www.aicpa.org/download/members/div/auditstd/AU-00220.PDF> and ET §100 – Independence, Integrity and Objectivity in AICPA *Code of Professional Conduct* at <http://www.aicpa.org/about/code/sec100.htm>) but also to meet the independence standards and interpretations of the Securities and Exchange Commission (SEC) (See Final Rule - Strengthening the Commission's Requirements Regarding Auditor Independence at <http://a257.g.akamaitech.net/7/257/2422/14mar20010800/edocket.access.gpo.gov/2003/pdf/03-2364.pdf> with later technical corrections at <http://www.sec.gov/rules/final/33-8183a.htm>.)

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.

Audit Options, Reports and Engagements (Miscellaneous Issues)

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____ No____

Please explain.

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.

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?

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?

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.

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.

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?

22. NCUA recently published a joint Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters. CUNA's analysis of the Advisory, which contains a link to the text of the Advisory, is available on CUNA's website at http://www.cuna.org/reg_advocacy/member/analysis/ffiec_021406.html. 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.

23. Other comments?

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