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New Supervisory Committee Requirements Webinar  
Thursday, October 29, 2020 | 10 A.M.

Dean Rohne, Principal  
Harrison Powers, Manager

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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# New Supervisory Committee Requirements

Presented by

Harrison Powers, CPA

Dean Rohne, CPA, CIA

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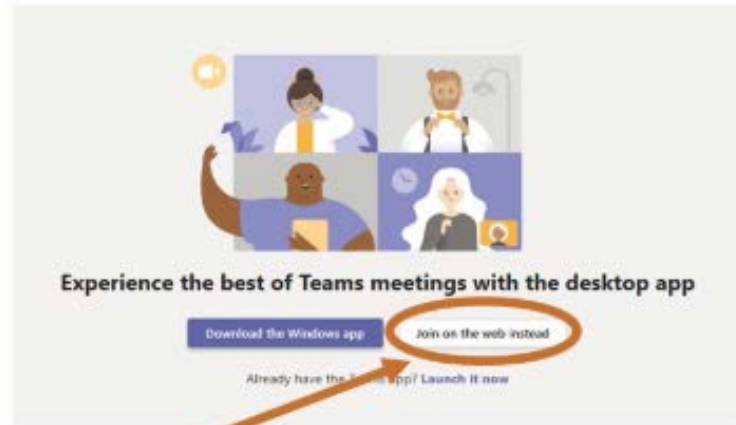
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# Session Objectives

- Review changes to Regulation 715
- Discuss the new reporting requirements
- Review of new minimum procedures
- Discuss best practices for meeting the supervisory committee audit requirements
- Considerations related to supervisory committees overseeing the internal audit function



# Supervisory Committee Regulations

Supervisory committee requirements addressed in NCUA Rules and Regulations 715

- Changes approved October 7, 2019
- Eliminates some options for meeting the audit requirement
  - Balance sheet audit eliminated
  - Attestation on internal controls over call reporting eliminated
- Removes the 120 day requirement for issuing reports
- Modifies the supervisory committee minimum procedures



# Supervisory Committee Regulations

## 715.1 – Scope of this part

- Requires an annual audit and member account verification based on the following:
  - ◇ Charter type
  - ◇ Asset size
- Instituted based on Credit Union Membership Access Act in 1998





# Supervisory Committee Regulations

## 715.2 – Definitions

- Includes key definitions used in Regulation 715, which includes items such as:
  - ◇ Compensated person
  - ◇ Financial statements
  - ◇ GAAP (generally accepted accounting principles)
  - ◇ GAAS (generally accepted auditing standards)
  - ◇ Internal control
  - ◇ Working papers





# Supervisory Committee Regulations

## 715.2 – Definitions

### – Internal control

- ◇ Refers to processes established by the board of directors, officers and employees designed to provide reasonable assurance of reporting and safeguarding of assets consisting of five components
  - Control environment
  - Risk assessment
  - Control activities
  - Information and communication
  - Monitoring

# Supervisory Committee Regulations

## 715.3 – General responsibilities

- a. Basic – ensure board of directors and management meet financial reporting objectives and have practices to safeguard members' assets
- b. Specific – supervisory committee must determine:
  - ◇ internal controls are established and achieve credit union's reporting objective which must be sufficient to meet supervisory committee audit requirements
  - ◇ Credit union's accounting records and financial reports are promptly prepared and accurate



# Supervisory Committee Regulations

## 715.3 – General responsibilities

### b. Specific – supervisory committee must determine (continued):

- ◇ Relevant plans, policies, and control procedures established by the board of directors are properly administered
- ◇ Policies and control procedures are sufficient to safeguard against error, conflict of interest, self-dealing, and fraud

### c. Mandate

- ◇ Ensure credit union adheres to measurement and file requirements
- ◇ Perform supervisory committee audit
- ◇ Verify member accounts
- ◇ Act to avoid imposition of sanctions for failure to comply with this part

# Supervisory Committee Regulations

## 715.4 – Audit responsibility – annual audit requirement

<b>Type of Charter</b>	<b>Asset Size</b>	<b>Minimum Audit Required to Fulfill Supervisory Committee Audit Responsibility<sup>a</sup></b>	<b>Part 715 section</b>
<b>Federal charter</b>	\$500 Million or more	Financial statement audit per GAAS by independent, State-licensed person	§ 715.5
	Less than \$500 Million but greater than \$10 Million	Either financial statement audit or other supervisory committee audit options	
	\$10 Million or less	Either of three supervisory committee audit options	
<b>State charter</b>	\$500 Million or more	Financial statement audit per GAAS by independent, State-licensed person	§ 715.6
	Less than \$500 Million	Either of three supervisory committee audit options unless audit prescribed by State law is more stringent.	

# Supervisory Committee Regulations

## 715.7 – supervisory committee audit alternatives

- Credit union not performing financial statement audit may fulfil responsibilities by performing *Other Supervisory Committee Audit in accordance to appendix A.*
  - Can be performed by any of the following:
    - ◇ Supervisory committee
    - ◇ Internal auditor
    - ◇ Other qualified person
  - Only state license individuals can provide assurance



# Supervisory Committee Regulations

## 715.8 – verification of accounts

- a. Must be completed once every two years
- b. Methods
  - 1. Controlled verification of 100 percent of members' share and loan accounts
  - 2. Statistical method
    - a. Random selection, sample representative of the population, equal chance of selecting each dollar
    - b. Must be sufficient in both number and scope to based on management's financial reporting objectives
    - c. Additional procedures if not sufficient



# Supervisory Committee Regulations

## 715.8 – verification of accounts

### b. Methods (continued)

#### 3. Non-statistical

- Can only be by state licensed person in state where they are licensed consistent with GAAS
- Must be sufficient in both number and scope to provide assurance general ledger accounts are fairly stated in relation to the financial statements as a whole
- Documentation of sampling procedures upon request from NCUA

### c. Supervisory committee must retain documentation until next verification is completed.





# Supervisory Committee Regulations

## 715.9 – Assistance from outside, compensated person

- a. Must not be related to officials by blood or marriage
  - Management employee
  - Member of the board of directors, supervisory committee, or credit committee
  - Loan officer
- b. Engagement letter must be in place for an engagement for a financial statement audit or all or portion of supervisory committee audit and contracted directly with the supervisory committee

# Supervisory Committee Regulations

## 715.9 – Assistance from outside, compensated person

### c. Contents of the letter

- Terms, conditions, and objectives
- Basis of accounting
- List of procedures if performing the supervisory committee audit
- Rate of compensation
- Provide for a written report including any internal control reportable conditions and/or irregularities or illegal acts

# Supervisory Committee Regulations

## 715.9 – Assistance from outside, compensated person

### c. Contents of the letter (continued)

- Target date of delivery to meet annual audit requirements
- Provide unconditional access to working papers by NCUA staff and/or state credit union supervisor
- Retain working papers for a minimum of three years

### d. Complete scope

- If engagement is other supervisory committee audit intended to fully meet scope of 715.7, engagement letter must certify it will address at least minimum requirements of Appendix A

# Supervisory Committee Regulations

## 715.9 – Assistance from outside, compensated person

### e. Exclusions from scope

- If engagement is other supervisory committee audit and excludes any of the minimum requirements the letter shall
  - Identify the excluded items
  - State it will not meet full scope of supervisory committee audit
  - Caution the supervisory committee to remain responsible for fulfilling the scope of the supervisory committee audit



# Supervisory Committee Regulations

## 715.10 – Audit report and working paper maintenance and access

### a. Audit report

- Supervisory committee must verify written report was performed based on the terms of the engagement letter
- Report should be submitted to the board of directors
- Results must be reported orally or in writing at next annual meeting
- Supervisory committee must provide full audit report to a member of the NCUA upon request

### b. Working papers

- Supervisory committee responsible for preparing, maintaining, or making available complete set of original working papers
- Supervisory committee is required to provide NCUA access upon request



# Supervisory Committee Regulations

## 715.11 – Sanctions for failure to comply

- a. Sanctions – failure to comply with requirements or the terms of the engagement letter is grounds for:
  - Regional director to reject the supervisory committee audit and provide reasonable opportunity to correct deficiencies.
  - Regional director to impose remedies under 715.12
  - NCUA board to seek formal administrative sanctions against supervisory committee in accordance to section 206(r) of the Federal Credit Union Act
- b. State charters
  - NCUA shall provide state regulator an opportunity to impose a remedy satisfactory to NCUA before exercising authority under 741.202



# Supervisory Committee Regulations

## 715.12 – Statutory audit remedies for federal credit unions

### a. Audit by alternative licensed person

- NCUA board may compel a federal credit union to complete minimum requirements of 715.5 or 715.7 by an independent state licensed person for any year which the following three conditions are present:
  1. Supervisory committee has not obtained an annual financial statement audit or performed a supervisory committee audit
  2. Supervisory committee has obtained a financial statement audit or supervisory committee audit that does not meet requirements of 715
  3. Credit Union has experienced serious and persistent recordkeeping deficiencies as defined by paragraph C of this section



# Supervisory Committee Regulations

## 715.12 – Statutory audit remedies for Federal credit unions

### b. Financial statement audit required

- NCUA board may compel a federal credit union to obtain a financial statement audit in accordance with GAAS for any fiscal year with serious and persistent recording keeping deficiencies as defined by paragraph C of this section

### c. Serious and persistent recordkeeping deficiencies

- Considered “serious” if NCUA Board believes board of directors and management have not timely met financial reporting objectives and established practices to safeguard members’ assets.
- Considered “persistent” when it continues beyond a usual, expected or reasonable period of time



# Supervisory Committee Regulations

## Appendix A to Part 715

- Presents minimum procedures when choosing the “other supervisory committee audit” option
- Minimum procedures may not be adequate for all credit unions as designed for smaller, less complete credit unions and additional procedures may need to be supplemented
- Supervisory committee must apply judgement to determine procedures necessary to meet audit requirements
- Method of selection must be described for each area where a sample or selection was performed.



# Supervisory Committee Regulations

## Appendix A to Part 715 – Definitions

- Confirmation
  - written verification from a third party pertaining to an account balance or condition
- Materiality
  - statement, fact, or item which given full consideration of surrounding circumstances that its disclosure or method of treating it would likely influence the judgment of a reasonable person.
  - Typically would consist of balances or transaction volumes greater than five percent of net worth

# Supervisory Committee Regulations

## Appendix A to Part 715 - Procedures

- Review of board minutes to determine if there are any material changes to the credit union's activities or condition that are relevant to the areas
- Test and confirm material asset and liability accounts including at a minimum:
  - Loans
  - Cash on deposit
  - Investments
  - Shares
  - Borrowings
- Test material equity, income, and expense accounts
- Test for unrecorded liabilities



# Supervisory Committee Regulations

## Appendix A to Part 715 - Procedures

- Review key internal controls, at a minimum:
  - Bank reconciliation procedures
  - Cash controls
  - Dormant account controls
  - Wire and ACH transfer controls
  - Loan approval and disbursement procedures
  - Controls over accounts of employees and officials
  - Other real estate owned
  - Foreclosed and repossessed assets
- Test the mathematical accuracy of the allowance for loan loss account and ensure the methodology is properly applied
- Test loan delinquency and charge-offs



# Minimum Procedures - What's new?

- Need for testing of significant assets and liabilities
  - Fixed assets was not required to be tested in old procedures
  - Test of other assets and liabilities outside of clearing accounts
  - Minimum sample of 25 loans for documentation testing
- Income and expense
  - Was not previously included in the scope of the procedures
  - Testing of a sample of expenses
- Allowance for loan losses
  - Only testing if mathematically accurate



# Minimum Procedures - What's new?

- Personnel
  - Test a sample of ten percent of employees and test the following:
    - ◇ Hiring documentation
    - ◇ Annual performance reviews
    - ◇ Salary authorization
- Information Systems
  - Review of active users on data processing system compared to employee list
- Unrecorded liabilities
  - Must assess whether there are any unrecorded liabilities
  - Would include unrecorded employee benefits





# Regulatory Requirements for Internal Audit

- Interagency Policy Statement on the Internal Audit Function and Its Outsourcing:

“Effective internal control is a foundation for the safe and sound operations of a financial institution (institution). The board of directors and senior management of an institution are responsible for ensuring that the system of internal control operates effectively. Their responsibility *cannot* be delegated to others within the institution or to outside parties. An important element in assessing the effectiveness of the internal control system is an internal audit function.”



# Regulatory Requirements for Internal Audit

- Interagency Policy Statement on the Internal Audit Function and Its Outsourcing:
  - Outsourcing may be beneficial if properly structured, carefully conducted, and prudently managed
  - Agencies have concerns the structure, scope, and management of some IA outsourcing arrangements do not contribute to safety and soundness
  - Agencies want to ensure outsourcing arrangements do not leave directors and senior management with the erroneous impression they have been relieved of responsibility for maintaining effective system of internal controls



# Regulatory Requirements for Internal Audit

- Interagency Policy Statement on the Internal Audit Function and Its Outsourcing:
  - Part 1 – The internal audit function
    - ◇ Addresses board (supervisory committee for credit unions) and senior management responsibilities
  - Part 2 – Internal audit outsourcing arrangements
    - ◇ Includes both outsourcing and co-sourcing
    - ◇ Addresses items to include in contracts with vendors



# Regulatory Requirements for Internal Audit

- Interagency Policy Statement on the Internal Audit Function and Its Outsourcing:
  - Part 3 – Independence of the independent public accountant
    - ◇ Addresses independence and using the same firm for both financial statement audit and internal audit services
  - Part 4 – Examination guidance
    - ◇ Indicates examiners should have access to workpapers
    - ◇ Addresses what examiners will look for related to the internal audit function



# Regulatory Requirements for Internal Audit

- NCUA Examiner Guide Chapter 5
  - Provides general guidance for assessing the adequacy of internal audit based on NCUA Regulation 715
  - Emphasizes success of internal audit based on:
    - ◇ Independence
    - ◇ Adequacy and effectiveness of the audit program

# Regulatory Requirements for Internal Audit

- Washington Department of Financial Institutions (DFI) Division of Credit Unions Bulletin B-18-08
  - Provides guidance for credit unions that may outsource their internal audit function
  - Addresses how examiners will evaluate the outsourcing function
  - Based on policy statements from FDIC and FFIEC



# Regulatory Requirements for Internal Audit

- Washington (DFI) Bulletin B-18-08 (continued)
  - Examiners will exercise judgement on quality and scope of internal audit program regardless of whether it is performed internally or externally. The following may be considered in the evaluation:
    - ◇ IA function's risk assessment, audit plan, and audit programs
    - ◇ IA activities that have been adjusted for significant changes at the CU
    - ◇ IA activities consistent with long range goals and strategic direction of the CU





# Regulatory Requirements for Internal Audit

- Washington (DFI) Bulletin B-18-08 (continued)
  - IA Evaluation (continued)
    - ◇ Supervisory committee promotes IA independence
    - ◇ CAE is placed in management structure that does not impair independence
    - ◇ CU is promptly responding to significant internal control weaknesses
    - ◇ IA program is carried out timely including communication of results



# Regulatory Requirements for Internal Audit

- Washington (DFI) Bulletin B-18-08 (continued)
  - IA Evaluation (continued)
    - ◇ Workpapers adequately document IA work performed and support audit reports
    - ◇ Reasonable standards are used in performance of work, such as IIA Standards
    - ◇ IA provides high quality advice and counsel to management and board of directors related to risk management, internal control, and regulatory compliance
    - ◇ Competence of IA staff



# Regulatory Requirements for Internal Audit

- Washington (DFI) Bulletin B-18-08 (continued)
  - In addition the following will be assessed related to an outsourcing relationship:
    - ◇ Arrangement maintains or improves quality of IA function
    - ◇ Key employees of CU understand lines of communication with outsourcing function
    - ◇ Scope is revised with changes in CU operations and risk
    - ◇ Directors have ensured CU is managing outsourcing activities



## Regulatory Requirements for Internal Audit

- Washington (DFI) Bulletin B-18-08 (continued)
  - In addition the following will be assessed related to an outsourcing relationship (continued):
    - ◇ IA workpapers are property of the CU
    - ◇ Regulators will have access to workpapers
    - ◇ Independence standard is satisfied
    - ◇ Adequate due diligence on the vendor



# Supervisory Committee Best Practices

- Evaluate cost/benefit of different options to meet supervisory committee audit requirements
- Need for an engagement letter for all contracted work by the supervisory committee
- Supervisory committee should obtain an understanding of member verification process
- If choosing the supervisory committee minimum procedures need for understanding of the scope of the procedures



# Supervisory Committee Best Practices

- Obtain audit reports timely
- Clearly understanding key findings from audits
  - Opinion modifications from a financial statement audit
  - Adjustments to the financial statements, whether recorded or unrecorded
  - Deficiencies in internal control identified through the audit process
  - Other findings and internal control comments
  - Management's response to items listed above



## Closing Thoughts

- It is important for supervisory committees to understand the changes to regulation 715
- Need for the supervisory committee to understand scope of work performed to meet audit requirements and the results of that work
- Supervisory committee should take an active role in overseeing the audit function at the credit union
- Ask questions





Questions?

Harrison Powers, CPA

[Harrison.Powers@claconnect.com](mailto:Harrison.Powers@claconnect.com)

972-383-5776

Dean Rohne, CPA, CIA

[Dean.Rohne@claconnect.com](mailto:Dean.Rohne@claconnect.com)

507-434-7046

