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National Association of Federally-Insured Credit Unions

April 25, 2019

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Supervisory Committee Audits and Verifications (RIN 3133-AE91)

Dear Mr. Poliquin:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the National Credit Union Administration's (NCUA's) proposed rulemaking on supervisory committee audits and verifications. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 116 million consumers with personal and small business financial service products. The supervisory committee plays a vital role in a credit union's overall governance as it is tasked with broad responsibilities to ensure its institution has sufficiently met audit requirements. Part of this responsibility includes the identification of fraud, verification of accounts and determination of effective internal controls. NAFCU appreciates the NCUA's commitment to providing supervisory committees flexibility in performing their audit duties. NAFCU is supportive of the proposed rule's removal of the "report on examination of internal controls over call reporting" alternative audit option, and removal of the 120-day language in engagement letters to outside, compensated auditors regarding the required written report. Additionally, NAFCU is supportive of the flexible and streamlined Appendix A to Part 715 alternative audit option. However, NAFCU asks that the NCUA not include additional areas of review in Appendix A, and retain the Supervisory Committee Guide as a resource.

General Comments

Supervisory committee members are non-compensated, member-volunteers that serve in one of the most important aspects of the overall governance of a credit union. NAFCU appreciates the NCUA's Regulatory Reform Task Force's recommendation in removing outdated, ineffective, and excessively burdensome regulations pertaining to supervisory committee audits. The NCUA promptly approved this proposed rule well before the target date as estimated in the Second Regulatory Reform Task Force Report. NAFCU appreciates any regulatory relief for supervisory committee members that allows the fulfillment of statutory duties in an efficient manner.

Section 115 of the *Federal Credit Union Act* (FCU Act) requires supervisory committees to conduct an annual audit, submit a report of the audit to the Board of Directors, and provide a summary of the report to the members at the next scheduled annual meeting. Section 715.5(a) of

the NCUA's regulations require credit unions with over \$500 million in assets to obtain an annual independent audit of their financial statements. Credit unions under that threshold who do not voluntarily elect to have a financial statement audit completed by an independent party have the choice of alternative audit options. Under the current regulations, section 715.7 provides a credit union with three alternative options: (1) Balance Sheet Audit; (2) Report on Examination of Internal Controls over Call Reporting; and (3) Audit per Supervisory Guide. Approximately, 69% of NAFCU members have assets of less than \$500 million and may avail themselves of the alternative audit options. Thus, the proposed changes affect a majority of NAFCU members.

NAFCU Generally Supports the Proposed Rule

NAFCU is supportive of the proposed rule's changes to the delivery date of the written report from an outside, compensated auditor, as this change will provide credit unions with a flexible standard and negotiating power. Currently, section 715.9(c)(6) requires that an engagement letter specify a target date of delivery for a written report no more than 120 days from the calendar or fiscal year-end under audit. If a credit union wishes to use a different deadline, a waiver must be obtained from the appropriate NCUA Regional Director. The proposal amends section 715.9(c)(6) by eliminating the 120-day deadline required language, and replacing it with a new standard that would require credit unions to specify their own target delivery date in the engagement letter. Circumstances may arise, due to a credit union's asset size or complexity, whereby an outside auditor cannot reasonably provide the required written report within the 120-day timeframe, requiring the credit union to request a waiver from the NCUA.

The proposed rule eliminates the need to seek a waiver from the NCUA, alleviating credit unions from this burden, and allowing the agency to focus their efforts on more important matters. In addition, the flexible language provides credit unions with negotiating power that may lead to cost savings. Previously, auditors that had to expedite written reports within the required timeframe may have charged a premium in order to complete the written report in a timely fashion. Or, those written reports that took longer than the 120-day timeframe may have been costlier. Overall, NAFCU is supportive of the proposed rule's removal of the 120-day deadline of the written report from an outside, compensated auditor.

In addition, NAFCU is supportive of the proposed rule's removal of the "report on examination of internal controls over call reporting" alternative audit option based on the NCUA's data, which reports that less than 1 percent of all credit unions utilize this method. Although NAFCU appreciates the NCUA's allowance of multiple options to conduct a supervisory committee audit, the option is no longer a preferred method; therefore, the removal of the option is warranted. With the removal of this option, the NCUA may focus their efforts on improvements to the existing audit options for credit unions. Thus, NAFCU is supportive of the proposed rule's removal of this alternative audit option.

Supervisory Committee Guide

The proposed rule seeks to remove the “audit per supervisory guide” alternative audit option, and replace it with the option to conduct an audit that meets certain minimum requirements set forth in a newly proposed Appendix A to Part 715. Additionally, the proposed rule seeks to decommission the Supervisory Committee Guide. Proposed Appendix A provides a streamlined framework for supervisory committees, so NAFCU supports the proposed alternative audit option. As a result, supervisory committees, internal auditors, or other qualified individuals will be more likely to determine additional procedures necessary to supplement these minimum audit procedures based on their subjective risk profiles, product offerings, and field of membership. Given our ever-changing regulatory environment that continues to grow in complexity, it is important that supervisory committees know the minimum audit requirements, and have the ability to adapt audit procedures as necessary. Despite the potential positive impacts of proposed Appendix A, NAFCU members utilize the Supervisory Committee Guide.

NAFCU recommends that the NCUA not decommission the Supervisory Committee Guide, but instead allow credit unions to continue to use it as a resource. Although the proposal provides that the NCUA will issue reference material on procedures to meet the minimum requirements of Appendix A, the Supervisory Committee Guide is still a valuable resource. On the one hand, the Supervisory Committee Guide is daunting in size, or as the NCUA stated “overly specific, burdensome, and outdated.” But, on the other hand, it provides an all-encompassing guide that is helpful for audit questions and informational for newer supervisory committee members. NAFCU members utilize the Supervisory Committee Guide as a reference for audit best practices and to ensure the proper auditing of key areas. Smaller credit unions use the Supervisory Committee Guide as a framework for their internal operational audits, creating their own procedures for internal audits based on the guide, as it is more cost-effective.

Appendix A is designed for smaller, less complex credit unions, however, with only minimum standards listed, questions will likely arise. The Supervisory Committee Guide was also intended to be used by smaller, non-complex credit unions, but it provides more comprehensive guidance that is useful for many credit unions. Decommissioning the Supervisory Committee Guide removes a valuable resource for credit unions. Given that the Supervisory Committee Guide is not regularly updated, there is little to no cost to the NCUA in maintaining the guide as-is online. The Supervisory Committee Guide can be found under the “regulation and supervision” tab on the NCUA’s website in the “manuals and guides” link, and NAFCU recommends maintaining the guide there even after the reference materials for Appendix A are issued. In order to minimize confusion as to whether the guide allows for the fulfillment of audit requirements, a disclaimer can be added to the front page of the guide, or webpage under the guide’s link. The disclaimer may note that “this Supervisory Committee Guide is a resource to provide volunteers who participate on a supervisory committee at small and low-income credit unions a better understanding of their role and responsibilities; this guide does not fulfill any required audit requirements and credit unions must fulfill these requirements pursuant to section 715.7.” For these reasons, we ask that the NCUA retain the Supervisory Committee Guide as a resource for credit unions on their website.

The NCUA Should Not Include Other Areas of Review in Appendix A

Proposed Appendix A should not include other areas of review at this time. Minimum areas required for audit review should be listed, as proposed, allowing the individual credit union to decide whether other areas need to be included. Due to each credit union's unique field of membership, complexity, and products offered, the decision is best left up to the individual supervisory committee. Additional areas of review should only be within the scope of the supervisory committee's duties. As an example, the proposal suggests including the pay and benefits to employees as an audit area. Generally, this is a matter that is best left to the Board of Directors, management, and human resources staff. As the audit arm of the credit union, the supervisory committee is tasked with reviewing the internal controls related to pay and benefits, including reviewing whether adequate records exist and if the amounts paid are Board approved; however, they should not be tasked with deciding pay and benefits to employees.

This illustrates an area that blurs the lines between a supervisory committee duty and an operational decision. If the area of pay and benefits is added, the scope must be tailored to match the supervisory committee's duties. Additionally, the proposal suggests including the *Bank Secrecy Act* (BSA) as an audit area. A pillar of BSA compliance is to have a designated BSA officer, and the supervisory committee's duty is to verify the credit union has a BSA compliance program in place, and review the procedures. Inclusion of the BSA as an audit area blurs the lines of the individual responsible for compliance and the supervisory committee's independent audit duties. Therefore, NAFCU recommends that no additional areas of review be added to Appendix A at this time.

Other Supervisory Committee Considerations

NAFCU receives numerous member questions regarding the requirements and best practices of supervisory committees. Generally, the questions received fall outside the scope of this proposed rule regarding audit requirements; however, we wish to bring these questions to the NCUA's attention to flag issues and ambiguities credit unions have encountered. The questions NAFCU receives fall into the overarching categories of structure of the supervisory committee, and role or duties. To illustrate, recent questions NAFCU has received include: whether a face-to-face supervisory committee meeting must be held; whether supervisory committee meetings must be open to the credit union CEO and/or Board Chair; the role of the supervisory committee in relation to the Board of Directors; whether a supervisory committee charter is required; and the permissibility of appointing an "alternate" or "associate" supervisory committee members.

In all of the above situations, there are no articulated requirements that the supervisory committee must follow. Understandably, this ambiguity was to allow credit unions operational flexibility, and the ability to adopt individual procedures that work best for their credit union. The NCUA has provided some guidance on various supervisory committee questions spread among legal opinion letters and the Supervisory Committee Guide, but in certain situations neither provide a clear answer. For example, there are no express requirements for the establishment of a supervisory committee charter in the FCU Act, the NCUA's Model Bylaws, or the Supervisory Committee

Guide. If a credit union adopts a supervisory committee charter, there is no clear guidance or articulated requirement stating that the charter must be approved by the Board of Directors. In the absence of such guidance or requirement, the credit union must make a risk-based decision. NAFCU recommends that the NCUA provide more detailed guidance on the role and structure of the supervisory committee in order to provide clarity and mitigate ambiguities. Clearer guidance on their structure and role would allow supervisory committees the ability to focus on their important responsibilities in the overall governance of their credit unions.

Conclusion

NAFCU appreciates the opportunity to share its members' views on this matter. We are supportive of the removal of the “report on examination of internal controls over call reporting” alternative audit option. In addition, we support the flexible standard for the delivery date of the written report from an outside, compensated auditor. Lastly, NAFCU is supportive of the flexible and streamlined Appendix A alternative audit option, but recommends that the NCUA maintain the Supervisory Committee Guide on the NCUA’s website in its current location, and allow credit unions the continued use of this valuable resource. Should you have any questions or require additional information, please do not hesitate to contact me at (703) 842-2249 or kschafer@nafcu.org.

Sincerely,



Kaley Schafer
Regulatory Affairs Counsel