

Title 46 - DEPARTMENT OF BANKING AND FINANCE

Chapter 3 - CREDIT UNION SUPERVISORY COMMITTEE'S ANNUAL AUDIT

001 GENERAL.

001.01 This Rule has been promulgated pursuant to authority delegated to the Director of the Department of Banking and Finance ("Department") in Section 21-1732 of the Credit Union Act.

001.02 The Department has determined that this Rule is in the public interest.

001.03 The Director may, on a case-by-case basis, and with prior written notice to the affected person, require adherence to additional standards or policies, as deemed necessary in the public interest.

002 APPLICATION.

002.01 Section 21-1771 of the Nebraska Credit Union Act says in part, "Unless the credit union has been audited by a certified public accountant, the supervisory committee shall make or cause to be made a comprehensive annual audit of the books and affairs of the credit union. It shall submit a report of each annual audit to the board of directors and a summary of that report to the members at the next annual meeting of the credit union."

002.02 The certified public accountant or certified public accounting firm must apply to the Department on forms prescribed by the Department for approval to conduct the annual audit. The minimum standards to be met by an accountant selected to perform the annual audit of a credit union and the minimum standards of the annual audit itself are as set forth in this Rule.

003 QUALIFICATIONS.

003.01 A certified public accountant is deemed to be a person who is duly registered and is in good standing under the Nebraska Public Accountancy Act.

003.02 In the event the Supervisory Committee does not elect to provide for an annual audit by a certified public accountant or a certified public accounting firm, it must of itself make a thorough audit of the books, records, funds, and securities held by the credit union. This audit must be conducted in accordance with the provisions of this Rule. The Supervisory Committee may assign the performance of such an audit to one or more persons who may not necessarily be a member of such committee, provided that the report compiled thereof is made in accordance with this Rule and is verified as to its correctness and signed by a majority of the Supervisory Committee so attesting.

003.03 The audit report is to be made a part of the record of the credit union in accordance with Section 21-1771.

004 INDEPENDENCE.

004.01 If the Supervisory Committee chooses to cause the books and records of the credit union to be audited, the audit, to be acceptable, must be completed by a qualified certified public accountant or certified public accounting firm who is in fact independent. An accountant or accounting firm, will not be considered to be independent, if he, she, or it:

004.01A is connected with the credit union as an officer, committee member, director, attorney, or employee, or is a member of the immediate family of an officer, committee member, director, attorney, or employee of the credit union or any of its affiliates;

004.01B is the beneficial owner, directly or indirectly, of 5% or more of the shares of the credit union;

004.01C is a borrower from the credit union;

004.01D makes entries or postings of the books of account or performs any other operating functions for the credit union;

004.01E or any partner or principal of the accounting firm that receives any special consideration in any transaction with the credit union or has any interest, direct or indirect, financial or otherwise, in any real property owned by or securing any loan made by the credit union, or in any other operating activity or function of the institution; or has any substantial conflict of interest, or the appearance thereof, by reason of business or personal relationships with management or those individuals who are in a position to influence management or its decisions or functions.

004.02 An accounting firm which has a member who is not considered independent shall exclude such accountant from any personal involvement in the audit.

004.03 The foregoing requirements are not to be construed as all-inclusive criteria in judging the independence of an accountant or accounting firm, but rather as setting forth the most common conditions which contribute to a lack of independence. The certified public accountant or certified public accounting firm must adhere to the American Institute of Certified Public Accountants' rules for independence, unless further restricted by the rules or interpretations of the Department. It is the responsibility of an accountant or accounting firm to disclose to the Department any unusual relationships or affiliations which he or she or any member may have with the credit union, or any persons closely connected with the credit union, and to have resolved any questions as to his, her, or its independence before proceeding with the engagement. The accountant or accounting firm must state specifically in the report of audit or supervisory committee audit that he,

she, or the accounting firm has met the test of independence specified above and that he, she, or the accounting firm is in fact independent.

005 APPLICABILITY OF RULE.

005.01 If a Supervisory Committee elects to conduct the annual audit itself, the scope and reporting procedures of this Rule are also applicable.

006 STANDARDS FOR ACCEPTABILITY.

006.01 An annual audit of a credit union must be made in accordance with the minimum audit procedures outlined in this Rule to be acceptable. The Director of the Department has the responsibility to determine whether an audit is acceptable. The Director also has the authority to reject any audit which does not conform in all respects with prescribed requirements. If, at any time, it is found that the accountant or accounting firm has not followed recognized rules of ethics or conduct, or has not met the minimum standards of the Department, the audit may be rejected. Any misstatement of facts or circumstances or any misrepresentation of any kind knowingly made may not only cause an audit to be rejected but may also form a basis for the temporary or permanent disqualification of the individual(s) or firm from conducting similar audits.

007 SCOPE OF AUDIT.

007.01 General - The audit procedures listed below are minimum procedures to be performed under the provisions of Section 21-1771. They should not be construed as restrictive. Circumstances relating to individual engagements or situations encountered may make it necessary or desirable to expand certain procedures, apply alternate procedures, or extend audit procedures to other areas. The scheduling of the audit should be coordinated with the Department to avoid conflicts with the Department's examination. The audit shall include a review of the credit union's system of internal controls and operating procedures and the report shall include comments and recommendations from this review.

007.02 Minimum Audit Procedures

007.02A Control:

007.02A1 Commence audit on a surprise basis, specifically identifying which credit union personnel had prior knowledge of the audit timing, if any. Assume control over all negotiable items and records to be examined until procedures have been completed.

007.02B Cash, Cash Items, Foreign Currency, Clearings and Exchange:

007.02B1 Conduct a count of a portion of teller and vault cash on an unannounced basis; the timing and scope should avoid recognizable patterns. Reconcile cash counts to the general ledger. Examine cash items on a test basis, verifying legitimacy and collectability. Investigate any unusual or stale items and request

confirmation of totals of clearing and exchanges. Determine the disposition of larger return items.

007.02C Due From Credit Unions/Banks:

007.02C1 Examine (or prepare if necessary) credit union/bank reconciliations with correspondent institutions by obtaining statements for several days beginning with the audit date, and, on a test basis, compare checks and drafts with the records of instruments issued. Investigate any unusual or stale items. Confirm the balance directly with the related credit unions/banks.

007.02D Investments:

007.02D1 Total the securities ledgers, reconcile carrying values with applicable general ledger accounts, account for all securities by reviewing securities on hand and confirmation of those held by others. Review the investment portfolio to determine if all securities were purchased and/or being held in conformity with applicable statutes and regulations. Verify safeguarding procedures.

007.02D2 Review the method utilized by the credit union to determine the adequacy and/or need for an allowance for losses on investment account.

007.02E Loans:

007.02E1 Total the loan ledger cards or obtain a trial balance from the service center and prove totals on a test basis, or review the service center audit, and reconcile totals with applicable general ledger accounts. Examine loan documents for a representative number of each type of loan to determine if the terms conform to the credit union's loan policies and that they have accurately been entered into the computer if so applicable. See Section 012 of this Rule for confirmation requirements.

007.02E2 On a test basis review selected individual loan accounts to determine the accuracy of interest calculations.

007.02E3 Review the method utilized by the credit union to determine the adequacy and contributions to the allowance for loan loss account. Reconcile subsidiary records for charged-off loans to control records and apply transaction testing to a sample of reconciling items.

007.02E4 Review the transfer to allocated reserves, including allowance for loan loss, to determine that all transfers were made in accordance with the requirements of current applicable statutes and regulations.

007.02F Fixed Assets:

007.02F1 From the date of the prior audit, review transactions in the accounts, trace approval of major expenditures to the minutes of the Board of Directors' meetings, and test the computation of depreciation.

007.02G Share Accounts:

007.02G1 Total regular share account individual ledgers or obtain trial balances from the service center and prove totals on a test basis, or review the service center audit, and reconcile totals with general ledger accounts. Trace disposition of selected unposted items. See Section 012 of this Rule for confirmation requirements.

007.02G2 Total share draft account individual ledgers or obtain trial balances from the service center and prove totals on a test basis, or review the service center audit, and reconcile totals with general ledger accounts. Trace disposition of selected unposted items. See Section 012 of this Rule for confirmation requirements.

007.02G3 Total time deposit accounts or obtain trial balances from the service center and prove totals on a test basis, or review the service center audit, and reconcile totals with general ledger accounts. Trace disposition of selected unposted items. See Section 012 of this Rule for confirmation requirements.

007.02G4 On a test basis, review selected individual share accounts to determine the accuracy of interest calculations.

007.02H Income and Expense:

007.02H1 Test selected entries to both income and expense accounts by reviewing proper documentation for selected items. Ascertain on a test basis by some independent means that all "debits" and "credits" to the income and expense accounts have been recorded and have not been either understated or overstated. Review the related accounts of accrued income, accrued expenses, unearned discounts, and deferred income by testing "debits" and "credits" as above; ascertain that the balances in these accounts are fairly stated.

007.02I U.S. Savings Bonds, Travelers Checks, and Other Consigned Items:

007.02I1 Examine the credit union's most recent reconciliation of items on hand with memo controls and related confirmation from issuing agents, or, if such records are not available, count items on hand. Reconcile with total on consignment, and obtain confirmation from issuers.

007.02J Other Activities:

007.02J1 The Supervisory Committee is to perform risk assessments prior to the audit for other financial reporting risks such as digital assets, mortgage lending, and insurance activities, and determine whether higher risk areas should be included for testing within the scope of the engagement.

008 INTERNAL CONTROLS. The credit union's system of internal controls and operating procedures must be reviewed, and the audit report must include specific comments and recommendations from this review.

008.01 General:

008.01A Review accounting procedures for handling non-ledger assets, such as charged-off loans and recoveries;

008.01B Review minutes of Board of Directors, Supervisory and Credit Committees, and latest report of supervisory examiners; and

008.01C Trace authorities for dividends declared and transfers to reserves.

009 REPORTING.

009.01 A report must be prepared and submitted to the Board of Directors describing the scope of the audit and setting forth the findings and recommendations as a result of the auditing procedures performed and review of the credit union's operating procedures and system of internal controls. Any open or unreconciled item at the time the report is submitted to the Board of Directors must be disclosed and commented upon in the report.

009.01A The report must include the effective date of the audit, the starting and closing dates of the audit, and a statement that the minimum requirements outlined in this rule were met. The report shall include a balance sheet listing of the credit union's assets, liability, and capital, including the balance of the general ledger asset and liability accounts examined as of the audit date under the specific account headings.

009.01B A description of procedures followed, including those applied to the income and expense accounts, is to be a part of the report.

009.02 The Supervisory Committee must file an electronic copy or two paper copies of the report with the Department within 120 days from the completion of the audit, or authorize the accountant or accounting firm performing the audit to file an electronic copy or two paper copies of the report with the Department within 120 days from the completion of the audit.

009.03 Any defalcation discovered during the audit must be reported to the Department immediately by the Supervisory Committee. In the event the

Supervisory Committee does not report the defalcation immediately, the accountant or accounting firm performing the audit must report the defalcation immediately. The accountant or accounting firm conducting the audit should have the credit union authorize him, her, or it in advance of the audit to notify the Department of discovered defalcations.

010 BOARD OF DIRECTORS' RESPONSIBILITIES.

010.01 The condition of a credit union depends largely upon the quality of leadership supplied by the Directors. This means all Directors must be kept informed of the affairs of the credit union and give direction. The proper supervision of the affairs of a credit union requires that Directors keep themselves well informed. Accordingly, the Board of Directors may not delegate responsibility for its duties, but may assign the performance thereof. Any areas not fully covered by the accountant's or accounting firm's report are to be performed by the Board itself. Although the Board as a group may not be qualified to perform the more technical aspects of a credit union audit, it should be possible for the Board to satisfy itself as to the following:

010.01A The soundness and authenticity of the credit union's loans and its loan policies;

010.01B Adherence to investment policies;

010.01C The adequacy of insurance and surety coverage; and

010.01D The legitimacy and correctness of income, expenses, and dividends.

010.02 Copies of the audit report prepared by an independent accountant or accounting firms should be carefully reviewed and there should be a thorough understanding of the significance of all the details included therein.

011 SUPERVISORY COMMITTEE'S RESPONSIBILITIES.

011.01 The responsibilities of the Supervisory Committee closely parallel the responsibilities stated in Section 010 of this Rule for the Board of Directors. If an independent audit is to be performed, the Supervisory Committee has the obligation to assure its compliance with the Rule.

011.02 Deficient areas of operation are to be corrected to the satisfaction of the Supervisory Committee and the Board of Directors. If not corrected, the Supervisory Committee is charged by the statutes to proceed with suspension proceedings.

012 DIRECT CONFIRMATION WITH BORROWERS AND SHARE ACCOUNT HOLDERS.

012.01 The method of prescribing for the verification of accounts in connection with the annual audit is not to be construed as being a

requirement in conjunction with the actual annual audit. The method is deemed appropriate whether used by the Supervisory Committee or an authorized accountant or accounting firm during the annual audit.

012.01A Prepare and mail confirmation requests on all loan and deposit categories, including participation loans purchased and sold.

012.01B For participation loans purchased, confirm balances with the selling credit union only. For participation loans sold, confirm the balances sold with the purchasing credit union and the total balances with the borrower.

012.01C Mail confirmation requests to a selected number of members whose loans were charged-off since the last audit.

012.01D Mail confirmation requests for a selected number of dormant accounts and accounts with zero balances that have been closed since the last audit.

012.01E Confirmations returned as undeliverable or with exceptions and non-replies to positive confirmation requests should be followed up by review of underlying documents, subsequent activity, or other appropriate procedures.

012.01F List names of account holders not responding to positive confirmation requests and describe the procedures followed to determine the accuracy of these accounts.

012.01G All verifications must show a return address other than the normal mailing address of the subject credit union.

012.02 REPORT OF VERIFICATIONS.

012.02A A report of the results of the verifications is to be made to the Board of Directors within 120 days from the issuance of the verifications if 100% of the accounts are verified. A similar report is to be made within 30 days if a lesser percent of the accounts are verified.

012.02B A confirmation statistics summary showing the extent and results of the type of confirmation and type of account is to be submitted rather than the extent and results of such procedures under each specific account heading in the body of report.

012.02C Any accounts selected for confirmation which have not been, or cannot be, mailed or delivered to the customer must be so listed in the final report.

013 ENHANCED PROCEDURES. The Department may require a credit union presenting safety and soundness concerns to engage an independent certified public accountant or certified public accounting firm to perform external auditing services or may require a financial statement audit or other specified type of external audit.

