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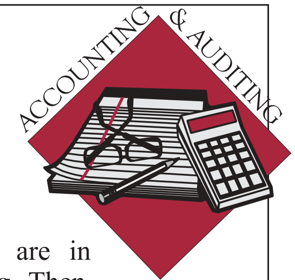

Audit on the Internal Controls over Financial Reporting: NCUA's Advanced Notice of Proposed Ruling Making

On February 16, 2006, the National Credit Union Administration (NCUA) issued an Advanced Notice of Proposed Rule Making (ANPR) seeking public input on possible changes to section 715 of the NCUA "Rules and Regulations." This section of the "Rules and Regulations" addresses a credit union's audit requirement. The NCUA is asking for input on several issues, one of particular importance is requiring an audit on the internal controls over financial reporting. The audit of financial reporting controls is required by the Sarbanes-Oxley Act (SOX) of 2002, but is not the first time the audit over financial reporting controls has been mandated by regulators.

In 1991 Congress enacted the FDICIA (Federal Depository Insurance Corporation Improvement Act). The FDIC Improvement Act was the result of the financial decline of bank, thrifts, and savings and loans during the 1980s. Many of these institutions failed while many others were near failure and significantly undercapitalized. These failures were due to poor decision making and a wildly changing economy. The implementation of the FDIC Improvement Act and other regulatory changes has helped strengthen the health of the bank and thrift industry. Although the credit union industry is not experiencing the issues banks did, there has been pressure to change our audit requirements and control reporting.

The Government Accountability Office (GAO) reviewed the credit union industry and reported their results in a letter dated October 2003. In this letter the GAO stated that to help ensure safety and soundness, Congress may wish to consider making credit unions subject to internal control reporting and attestation requirements applicable to banks and thrifts. At the same time we see requirements of SOX working their way into other areas of reporting and auditing. This year alone no less than seven new auditing standards are set to go into effect. These new standards address risk assessment and materiality. Within recent years, new standards on fraud assessment have been put in place. Over the last two years, many credit unions have implemented whistle-blower and board ethics policies, both ideas found in SOX. We will continue to see these and other concepts of SOX become the norm for auditing and the financial reporting control environment. The audit over financial reporting controls does come at a high cost. The question is can the benefit derived from this audit justify the cost?

> **"...one of particular importance is requiring an audit on the internal controls over financial reporting."**

The audit over financial reporting controls requires considerable work. In the first year, a great deal of effort must be put into identifying and/or creating controls as well as their documentation. Once completed, the controls must be continually tested so that Management can assert they are in place and working. Then the assertion audit must be performed by a certified Public accountant. Once again, the auditor must test controls to render an opinion on Management's assertion over their financial reporting controls. This will need to be done each year. Costs in the first year can be quite high depending on the use of consultants to assist in implementation. Ongoing costs associated with the assertion audit can vary, but an amount equal to 80% of the annual audit fee is a good estimate.

Whether or not credit unions should be required to have an audit over financial reporting controls will be decided by the examiners, but one has to appreciate the public trust given to credit unions as well as other financial institutions. Credit unions accept the public's money and hold it in trust. They process and hold personal financial information and in many cases the public entrusts them with their financial future. However, credit unions don't have the same troubles the banking industry had in the 80s. Credit unions don't have the same "for-profit" pressures as publicly traded institutions and are generally very well capitalized. There is a considerable cost associated with the audit over financial reporting controls, but an opportunity for improving financial reporting. It's a true cost vs. benefit situation and to what extent the benefit outweighs the cost will be decided by the NCUA.

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