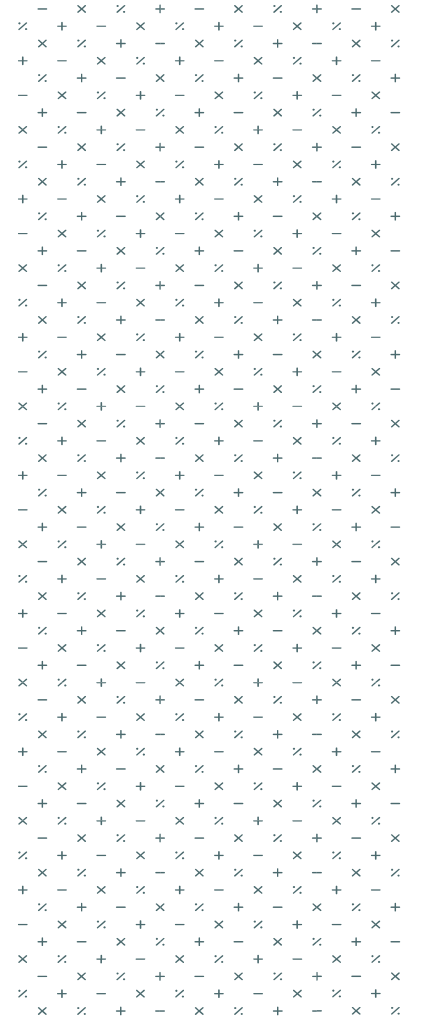




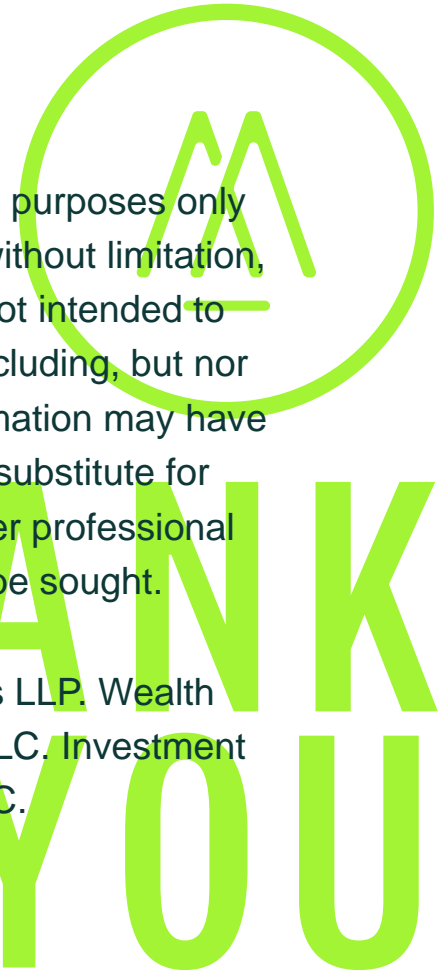
Effective Governance

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Agenda

- Supervisory Committee (SC) Governance – Scope
- Basics of Governance
- SC Responsibilities
- Planning
- The External Auditor
- In-house vs Outsourced
- In-house Internal Audit
- Regulatory Compliance
- Outsourcing Internal and Compliance Audits
- Understanding Risks in Your Credit Union
- Open Discussion/Questions



Supervisory Committee Governance – Scope

- This presentation outlines specific governance requirements as defined by NCUA Rules and Regulations and the Federal Credit Union Act.
- NCUA Rules and Regulation and the Federal Credit Union Act govern Federally chartered credit unions
- States generally adopt all or most of the Federal guidelines to govern their state chartered credit unions. Further, states can have their own unique laws and regulations governing their state chartered credit unions in addition to the Federal guidelines. To maintain effective governance, it is important to be aware of and understand these state specific laws and regulations as part of your duties.



Basics of Governance – The SC

- Part 715 of the NCUA Rules and Regulation defines a supervisory committee consistent with Section 111(b) of the Federal Credit Union Act, 12 U.S.C. 1786(r)
- **Appointment:** The board of directors appoints the supervisory committee, determining the number of committee members.
- **Term of service:** The board of directors determines the term.
 - The terms are for one, two, or three years.
 - All terms must be for the same number of years in total.
 - Terms should be staggered with one position up for appointment each year thus providing continuity to the committee.
 - The regular terms expire after the first regular board meeting following the annual meeting.



Basics of Governance – The SC

- One member of the supervisory committee may be a director other than a compensated officer.
- **Committee leadership:** The committee members select a chairperson and a secretary.
 - The offices of chairperson and secretary may be held by the same person.
 - The Secretary must maintain a record of actions taken by the committee
 - Minutes of meetings should be kept and summarize procedures performed
 - Credit Union information is confidential
- **Qualifications:** A supervisory committee member:
 - Must be a member of the credit union
 - Must be bondable by the credit unions surety bond company
 - May not be an employee of the credit union
 - May not be on the credit committee of the credit union



Basics of Governance – The SC

- The SC may attend board meetings, however, attendance is permitted only with the permission of the board
 - The committee members do not have an unqualified right to be present.
- The NCUA recommends at least one SC member to attend each board meeting as approved by the board.
- The board must publish minutes and the minutes must be available to the supervisory committee for its (or its designee) review.



Basics of Governance – SC Responsibilities

The SC has two general goals:

- 1.TO ENSURE THAT MANAGEMENT’S FINANCIAL REPORTING OBJECTIVES HAVE BEEN MET**
- 2.TO ENSURE THAT MANagements PRACTICES AND PROCEDURES SAFEGUARD MEMBERS’ ASSETS**



Basics of Governance – SC Responsibilities

To meet the two general goals, the SC is responsible for determining whether your credit union managers have:

- Established and maintained effective internal controls to achieve the credit union's financial reporting objectives. These controls must meet the requirements of the supervisory committee audit, verification of members' accounts and your additional responsibilities.
- Promptly prepared accounting records and financial reports to accurately reflect operations and results.
- Properly administered the relevant plans, policies, and control procedures established by the board of directors.
- Established policies and control procedures that safeguard against error, carelessness, conflict of interest, self-dealing and fraud.



Basics of Governance – SC Responsibilities

The SC makes these determinations primarily through conducting audits and verifications as follows:

- At least once every calendar year, you must complete (or have completed) the supervisory committee audit, and provide a report on the audit to the board of directors.
 - The audit must cover the period elapsed since the last audit period.
- At least once every two years, you must conduct a verification of members' accounts.
- You must ensure that the board of directors is safeguarding assets, and that management complies with their policies and plans.
- You must report to members at the annual meetings as stipulated in Article V of the standard bylaws.



Basics of Governance – SC Responsibilities

The SC also should:

- Review internal controls.
- Hire and work with an internal auditor (if feasible for the credit union).
- Hire and work with the external auditor (if feasible for the credit union).
- Review examination and audit findings and follow-up to ensure that management takes the necessary corrective action. The action taken must be adequate to correct the findings.
- Meet with the federal examiner as you or the examiner may request.
- Research member complaints.



Basics of Governance – SC Responsibilities

The SC should also consider the following additional procedures:

- Concentrate additional review on any areas of weakness identified in the annual audit or examination. Reference the audit chapters for guidance in reviewing these particular areas. The auditor or examiner may request that you complete certain procedures.
- Conduct surprise cash counts.
- Reconcile or verify the accuracy of the credit union's bank reconciliation for three concurrent months .
- Review all official, employees, and family member's accounts for preferential treatment and unusual activity.
- Review a sample of loans for deficiencies in documentation or quality.



Basics of Governance – SC Responsibilities

Additional procedures to consider:

- Call a sample of members with new loans to ensure that the loans are legitimate, representing the call as an informal survey.
- Trace a sample of new members to ensure that they are eligible for membership.
- Review internal control reports (for example, supervisor override reports, nonamortizing loan reports, etc.)
- Ensure that all employees take at least one week of continuous vacation.
- Help the auditor with the annual audit, if requested.



Basics of Governance – SC Actions

The SC has several tools at its disposal to intervene when it identifies that a general goal is not met by management of the credit union

- The SC may suspend, by unanimous vote, any board member, executive officer, or credit committee member
- The SC may call a special meeting (by a majority vote) to consider any violation of the:
 - FCU Act
 - Rules and Regulations
 - Charter
 - Bylaws
 - Any practice considered unsafe or unauthorized



Basics of Governance – Resources

For two general goals, there is a lot to cover for the SC. To help, the NCUA has helpful resources available on its website:

- The *Supervisory Committee Guide for Federal Credit Unions* has an assortment of tools to guide the SC in completing the required audits and verifications and overall responsibilities that when used will increase the overall effectiveness of the SC in meeting the two general goals.
- The NCUA website has video trainings discussing the SC's roles and responsibilities specific to the governance of its credit union.
- *Accounting Manual for Federal Credit Unions*
- *Federal Credit Union Act*
- *NCUA Rules & Regulations*
- *Letters to Credit Unions*
- *Letters to Federal Credit Unions*
- *NCUA Examiner's Guide*



SC Responsibilities – Overall Effectiveness

Questions to consider:

- Does the SC have a plan to meet its two general goals? Is it effective?
- What could the SC do to increase its overall effectiveness of meeting its two general goals?
- Does the SC have the skillset to perform the notated procedures effectively?
- What additional considerations outside the standard outlined scope would increase the SC's effectiveness of meeting its goals?



Planning

- Planning is the most important piece to effectively managing SC duties
- Have an understanding of what the regulatory requirements for your position as a SC member are, know what the regulations require the SC to do.
- Become familiar with the risk of loss at your credit union



Planning

- Know what your resources are, their skill sets and your overall budget for third party providers
- The NCUA Supervisory Committee Guide for Federal Credit Unions specifically notes “While your responsibilities encompass a range of areas, the depth of your review can vary. The internal control structure, size, complexity, and financial stability of your credit union will influence the extent of your review”
- Determine what an appropriate scope would be for certain procedures based on the complexity of the internal control



Planning

Develop a plan to meet the two general goals based on regulatory requirements and risk.

- **Develop a work plan over a 2-4 year period whereby you will cycle procedures based on risk and regulatory requirements; three year plans are often used.**



The External Auditor

- When selecting external auditors, the supervisory committee should start by evaluating the credit union's relationship with the current auditors.
 - Do they do a good job overall, and have a good relationship with the SC and management?
 - Do their reports contain comprehensive findings and recommendations?
 - Do their audits appear thorough, are they spending enough time?
 - Are they available to meet with the SC and management outside of the audit?
 - Do they have limited turnover and good resources?
- Items to keep in mind
 - If you have been using the same audit firm for years, and they are doing an effective audit (based on the basic criteria above) then its likely that no change is needed.



The External Auditor

- If you have been using the same audit firm for years, and they are NOT doing an effective audit (based on the basic criteria above) then its likely that a change is needed.
- When choosing a new auditor, key items to consider to effectively hire a new auditor:
 - Experience working with credit unions and other financial institutions and available resources
 - Firm reputation
 - Total hours expected to be spent to complete the audit and related hourly rate
 - Value, value doesn't mean lowest cost or lowest per hour rate. What are you getting?
 - Most importantly, relationships.
 - Check references to understand how the firm interacts with its referenced clients
 - Meet with the firms to interact with them directly and get to know them, there is only so much you can determine when just looking at a proposal.
 - Determine if the audit team is someone that is a good working fit for management and SC for the long term.



In-House vs. Outsourced?

- While the SC responsibilities encompass a range of areas, the depth of the SC review can vary. The internal control structure, size, complexity, and financial stability of the credit union will influence the extent of the SC review.
- Properly understanding what the skillsets the SC and the credit union's internal audit department (if available) have and what tasks they can effectively perform is a key consideration in determining the need is to outsource certain procedures to maintain the SC's overall effectiveness in meeting its two basic goals.



In-House Internal Audit

Considerations of effectiveness of the internal audit department:

- Who does the IA department report to?
- Does the IA department have a completed risk assessment that guides the IA plan and objectives?
- Is the department's size and structure adequate to meet its established objectives?
- Are the IA objectives mapped back to the SC requirements?
- Is the experience, technical expertise and knowledge of financial institutions and related risks adequate?
- Does the IA department get adequate CPE and industry training to stay current on credit union risks and compliance changes?
- Is the IA department's work planned properly?
- Are there written audit plans and programs?
- Are reports issued by the internal audit department to the SC? Are reports issued timely?
- Do the reports contain sufficient detail for effective action by management and the SC?



Regulatory Compliance

- Regulatory compliance is complex and constantly evolving.
- Effectiveness of completing regulatory compliance audits internally by the internal audit department can be limited due to the continued increases in complexity and constant evolution.



Outsourcing Internal and Compliance Audits

- When selecting internal and compliance auditors, the supervisory committee should start by evaluating the credit union's current internal and compliance auditors
- Key considerations for hiring and selecting internal and compliance auditors:
 - Are their audit plans established utilizing a risk assessment as established by the SC?
 - The SC should play a key role in determining what the audit plan is and making sure that a robust risk assessment is performed.
 - Do they do a good job overall, and have a good relationship with the SC and management?
 - Do their reports contain comprehensive findings and recommendations?
 - Do their audits appear thorough, are they spending enough time?
 - How robust are the reports that are being issued? How helpful are they in assisting the SC in its two goals?
 - Are they doing the same procedures over and over again without evolution and adaptation to risks?
 - Are they available to meet with the SC and management outside of the audit?
 - Do they have limited turnover and good resources?



Outsourcing Internal and Compliance Audits

- Some internal auditors do not perform a risk assessment even when the credit union does not perform internally. Without a risk assessment, overall effectiveness of the function will decrease dramatically.
- Items to keep in mind:
 - If you have been using the same audit firm for years, and they are doing an effective audit (based on the basic criteria above) then its likely that no change is needed.
 - If you have been using the same audit firm for years, and they are NOT doing an effective internal and compliance audit (based on the basic criteria above) then its likely that a change is needed.



Understanding Risks in Your Credit Union

- A robust understanding of risks specific to your credit union is a key foundation in the SC meeting its intended goals?
- The seven basic areas of risk regulators focus on are:
 - Credit Risk
 - Interest Rate Risk
 - Liquidity Risk
 - Transaction Risk
 - Compliance Risk
 - Strategy Risk
 - Reputation Risk



Understanding Risks in Your Credit Union

- Understand the basics of each risk specific to your credit union and understand how the SC's planned procedures address these risks?
- Is there anything not covered that should be?



Understanding Risks in Your Credit Union

- **Common risks that could allow for ineffective performance of SC's two stated goals if not properly understood:**
 - **Loan portfolio offerings and related risks**
 - New loans types, are they appropriate for the credit union to offer
 - Loans approved outside of policy
 - Loan concentrations
 - Indirect lending
 - Staying educated on specific risks within their portfolio, as they evolve
 - **Allowance for loan losses**
 - Is management's model in line with the regulators joint policy statement?
 - Are qualitative factors utilized, are they properly documented?
 - Do they appear to address risk appropriately?
 - Are there portfolios with limited to no allowance? Is this reasonable?
 - Do external auditors and/or regulators have comments on the allowance consistently?



Understanding Risks in Your Credit Union

- Tracking of internal audit, compliance, external audit, and regulatory deficiencies
 - Establish and understanding of the issue, how it effects the credit union and viable solutions to address
 - Are deficiencies being resolved by management?
 - Are there recurring deficiencies?





Open Discussion & Questions

