

Supervisory Committee

Bryan Fury, MSISM, CISSP, CRISC

bfury@corporateone.coop

614-825-9378

So What Are We Talking About Today?

- Regulatory Requirements of Supervisory Committees
- SC Member Qualifications
- SC Responsibilities
- Administration of the Committee
- Internal Control Warning Signs
- Resources

Regulatory Requirements

- Section 715.3 of NCUA's rules and regulations states the Supervisory Committee is responsible to determine that:
 - The financial condition of the credit union is accurately presented
 - That management practices are sufficient to safeguard assets
 - That accounting records are prepared promptly
 - That internal controls are established and effectively maintained
 - That plans, policies and control procedures established by the Board are properly administered
 - Policies and control procedures to safeguard against error, carelessness, fraud and self-dealing have been established

Regulatory Requirements - continued

- The annual external audit, internal audit functions and verification of member accounts are the activities generally used to carry out these responsibilities.

Supervisory Committee Qualifications

- Must be a member of the Credit Union
- No employee of the Credit Union may be a member of the committee
- Terms of all the members shall be the same number of years – either 1, 2 or 3 year terms.
- Experience in bookkeeping, accounting or auditing is helpful but not required

Primary Attributes

- Committee members possessing such qualities as:
 - Inquisitiveness
 - Professional skepticism
 - Good communication skills
 - Willingness to invest time

Supervisory Committee Responsibilities

- As a practical matter, the role of the supervisory committee consists of the following responsibilities:
 - Ensure that the annual audit requirement is fulfilled
 - Ensure that the verification of member accounts is performed when required
 - Monitor internal controls
 - Monitor financial trends and reporting

Supervisory Committee Responsibilities -continued

- The vast majority of credit unions hire an outside firm to conduct the audit
- Under current regulation, the annual audit requirement can be satisfied by one of the two following engagements:
 - An opinion audit (CPA)
 - A Supervisory Committee Guide Audit engagement (non-opinion) that can be done by a CPA or any other person

Opinion Audit

- Can only be done by a licensed CPA
- Results in CPA expressing an opinion on the fairness of the credit union's financial statements
- Places responsibility on the auditor to follow GAAS
- Highest level of audit engagement possible, that demonstrates the credit union's due diligence in conforming to the audit regulation

SC Relationship with Independent Auditor

- Selection of the CPA firm
- Understanding the CPA firm's quality controls system
- Making it clear who the CPA firm is working for
- Communication with the CPA firm
 - Planning Stage, Fieldwork, Reporting

Non-Opinion Exam

- Work can be done by a CPA or anyone
- Engagement Letter
- Procedures
- No Opinion Expressed
- Observations & Recommendations

Supervisory Committee Responsibilities (CPA Audit)

- Questions the CPA firm should answer:
 - What are the significant accounting policies?
 - Did the credit union select the accounting policies that were most appropriate?
 - How would you characterize management's judgements and estimates related to the financial statements?
 - Any significant audit adjustments?
 - Were there any waived adjustments?
 - Did you have any disagreements with management?
 - Did you encounter any difficulties in conducting the audit?
 - Are there any significant risks that management is not addressing?

Supervisory Committee Responsibilities (CPA Audit)

- Questions to ask the external audit firm:
 - What did you perform for unpredictable procedures as part of your audit this year?
 - If you had to mention one thing that could improve the effectiveness of the audit, what would it be?
 - Are there any potential internal control problems that you discussed with management?
 - How many people are in your firm's credit union group?
 - Did you rotate any staff on the audit job from the prior year?
 - How do you ensure a fresh look each year?

Supervisory Committee Responsibilities (CPA Audit)

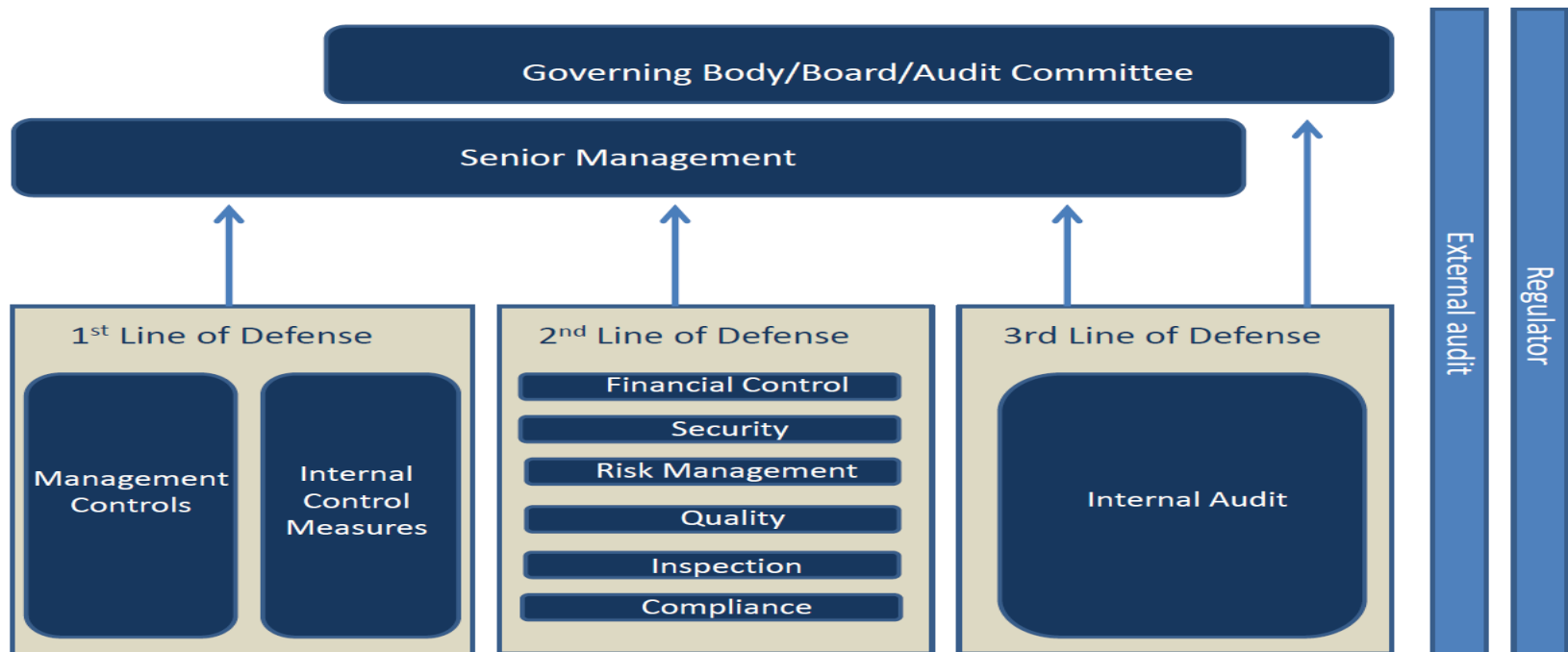
- Consider the CPA firm as a resource.
- Evaluate the auditor and audit process after the financial reports and management letter have been issued.
- Review the verification of member accounts performed by the CPA firm.
- Ascertain that the audit fee is appropriate.

Supervisory Committee Responsibilities (Internal Audit)

- Relationship with the internal auditor
 - Internal, outsourced or co-sourced
 - Establish an open line of communication
 - Determine sufficiency of independence
 - Tie risk assessments to IA plan
 - Evaluate ability of IA in relation to risk areas

Clear Communication Channels

The Three Lines of Defense Model



Internal Controls

- Definition: A credit union's organization and systems of procedures that provides a reasonable assurance that errors or irregularities will be prevented or detected in a timely manner.

Question: Who is responsible for the design and execution of the internal control system?

- A - The Board of Directors
- B - The Internal Auditor
- C – Management
- D – The Supervisory Committee

Internal Controls

- The design and execution of the systems of internal controls is the responsibility of management
- Common Examples:
 - Segregation of duties
 - Independent review of reconciliations
 - Review of exception reports

Supervisory Committee Responsibilities- Internal Controls

- Questions to ask management:
 - What criteria do you use to evaluate internal control systems?
 - Discuss the ‘Tone at the Top’ and what you do to maintain it?
 - Is there a fraud hotline and how are employees informed about it?

Supervisory Committee Responsibilities – Internal Controls

- More Questions:
 - Were any reported conflicts of interest or irregularities reported during the year?
 - Have the auditors identified major control deficiencies?
 - Can we have a tracking report of audit & regulatory findings and status of management's responses?
 - Is there a manager designated as responsible knowing and understanding relevant legal and regulatory requirements?

Supervisory Committee Responsibilities – Internal Controls

- Keep up-to-date on changes in your credit union
 - New products and services
 - Changes in field of membership
 - Mergers, key personnel changes
 - Technology changes

Supervisory Committee Responsibilities – Internal Controls

- Keep up-to-date on changes in the industry
 - Interest Rate Risk
 - Cybersecurity Threats
 - Money Service Businesses
 - Student Loans
 - Regulatory and Accounting

Committee Administration

- Create a charter
- Get the right people on the bus
 - Independent, objective & competent
 - Financial literacy
 - Collective skills is what is most important
 - Use outside advisors when necessary
- Continuing education is essential

Committee Administration

- Get the right information at the right time
- Set meeting agendas
 - Cover Issues Tracking Reports
- Conduct regular meetings w/ minutes
- Make annual report to the membership

Internal Control Warning Signs

- Complex business arrangements
- Last minute transactions that result in improvement in financial performance
- Change in estimates that are hard to understand
- Frequent differences between management & auditors
- Management not responsive to findings

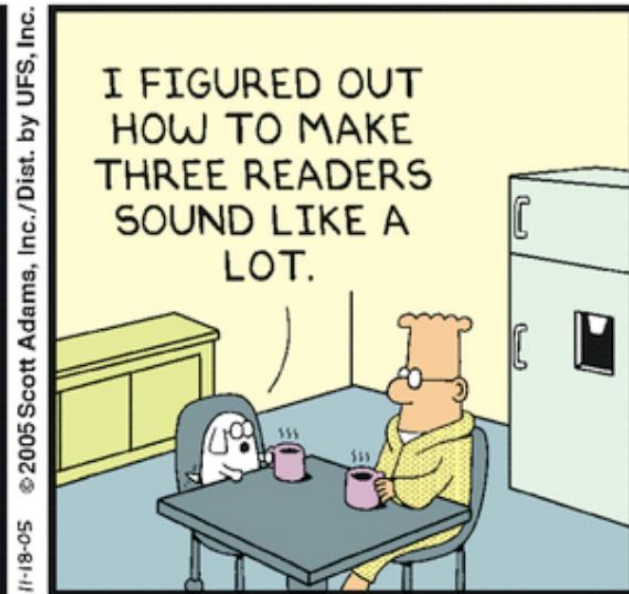
Internal Control Warning Signs

- Lack of 'Tone at the Top' approach
- High turnover of senior management
- Usually rapid growth or profitability compared to peers

Potential Organizational Weaknesses

- Fraud reporting process not clear
- Training schedules not formalized
- Suspense and clearing accounts are not reconciled and reviewed
- Issue tracking reports not produced or maintained
- Lack of periodic logical access reviews
- Employee accounts not reviewed

It's Always Good to Get Clarification



www.dilbert.com scottadams@aol.com

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Contact Information

Bryan Fury

Vice President Enterprise Risk
Management

614.825.9378 (O)

614.701.7561 (C)

bfury@corporateone.coop



It's where you belong.