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Ethics – Whistleblower Policy and Role of the Audit

ACUIA Region 4 Conference

Charlie Shannon, Partner

Financial Institutions Group



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Agenda

- Overview
- Rules and Key Aspects
- Whistleblower Program
- Role of the Audit
- Appendix A: Supervisory Committee Effectiveness

NOTE: AUDIT COMMITTEE AND SUPERVISORY COMMITTEE MAY BE USED INTERCHANGEABLY THROUGHOUT THE PRESENTATION.

What are we talking about? Why does this matter?

- The question is, how do we know that all employees are acting with integrity.
- How can someone report unethical behavior in a safe manner?
- Reputational risks to the organization are tremendous and cannot be understated.
- The credit union's members can be negatively impacted by poor corporate governance.



Big Picture

- Whistleblower program allows for prevention and detection of unethical behavior.
- Effective corporate governance framework can mitigate risk.
- Education is a key component to success.
- Supervisory committee, internal audit and external auditors are integral to overall process.



ERM RISK COMPONENTS

Regulatory Risk Categories



Credit Risk

Interest Rate Risk

Liquidity Risk

Transaction Risk

Compliance Risk

Strategic Risk

Reputation Risk

Credit Risk

Market Risk

Liquidity Risk

Operational Risk

Legal Risk

Reputational Risk

Credit Risk

Market Risk

Liquidity Risk

Operational Risk

Business Risk



Regulatory Capital Rules Framework for Classification of Risk Types

Risk Type	Definition
Credit Risk	Loss due to a borrower's inability to meet its financial obligations.
	Loss due to change in borrower's credit quality.
Market Risk	Loss due to change in market value of traded positions.
	Loss due to impact of changes in cost to close accrual positions (primarily interest rate risk).
Operational Risk	Loss resulting from inadequate or failed internal process, people and systems, or from external events. The definition includes legal risk. The definition does not include strategic or reputational risks.



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Whistleblower Provisions

Applies to public companies only:

- Governed by Dodd-Frank Act Section 924 (SEC)
- Whistleblowers are entitled to collect 10-30% of the total recovery in any resulting action or settlement by the SEC
- Fears of increased whistleblowing, more lawsuits and increased compliance costs
- Can require more involvement from legal counsel



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Whistleblower Rules for Public Companies

- SEC Final Rule (Release No. 34-64545) *Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934.*
- Requires SEC to pay an award to eligible whistleblowers that voluntarily provide the SEC with original information about a violation of federal securities laws leading to successful enforcement of a covered judicial or administrative action.
- Applies to individual or aggregated sanctions of \$1 million or more.
- Clarifies expectations and adjustments to awards when whistleblowers utilize (or do not utilize) internal compliance functions.
- Extends “lookback” period for whistleblower SEC reporting and award to 120 days after date of initial internal report.
- Final rule provides clarification of:
 - Definition of a whistleblower.
 - Anti-retaliation protections to individuals providing information about possible securities violations.

NCUA Rules and Regulations

- NCUA does not have a provision explicitly requiring that credit unions make a hotline available for whistleblower employees.
- NCUA expects that member credit unions will incorporate whistleblower program within its Fraud Policies and Procedures.
- Section 1790b of the Federal Credit Union Act has a provision protecting whistleblowing employees against retaliation.
- NCUA has a fraud hotline for the reporting of suspicious or illegal activity directly to NCUA.
- Board members are responsible for exercising due care to ensure that internal controls address the risk of fraud.
- NCUA examinations will continue to be focused on internal controls over fraud.



How does your credit union compare to industry averages?

FREQUENCY OF INCIDENT CATEGORIES

The following, from The Network's 2014 Corporate Governance and Compliance Hotline Benchmarking Report, looks at the frequency of employee reports to whistleblower hotlines, per 1,000 employees, by industry.

Goldilocks: too many instances can place undue burden on the process, while too few can indicate that there are possible instances that should be reported

Incident Type	2009	2010	2011	2012	2013
Company/Professional Code Violation	11%	12%	12%	12%	12%
Corruption & Fraud	13%	12%	12%	13%	12%
Customer/Competitor Interaction	4%	4%	3%	3%	3%
Employment Law Violation	12%	13%	14%	15%	16%
Environment, Health & Safety	5%	5%	5%	6%	5%
Misuse of Assets/Information	2%	2%	2%	2%	2%
Personnel Management	48%	48%	47%	46%	45%
Other	4%	4%	4%	4%	4%

How does your credit union use social media to assess risk?



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Employees should be encouraged to report any unethical behavior due to reputational and operational risks.

Personnel Management	<ul style="list-style-type: none">• High percentage among Construction, Manufacturing, Mining, Services Industries, Transportation, Communications & Utilities; Wholesale Trade and Retail Trade• Low percentage in Public Administration and Finance, Insurance & Real Estate	45%
Employment Law Violation	<ul style="list-style-type: none">• High percentage for Transportation, Communications & Utilities• Low percentage in Finance, Insurance & Real Estate	16%
Corruption & Fraud	<ul style="list-style-type: none">• High percentage in Public Administration – this is consistent over the past five years• High in Mining• Low in Construction and Transportation, Communications & Utilities	12%
Company/ Professional Code Violation	<ul style="list-style-type: none">• Extremely high percentage in Finance, Insurance & Real Estate– this is consistent over the past five years• Relatively high in Public Administration – consistent over the past five years• Low in Construction, Services Industries, and Wholesale Trade	12%

**Note: Percentages may not total up to match industry totals due to rounding.*

Source: The Network.



How to Avoid the “Whine Line”

- Make sure employees have a clear understanding of how whistleblower reports will be handled.
- Anonymity and independence are critical to success.
- Most instances are HR related vs. financial.
- Report statistics to key stakeholders.



Features of Well Defined Whistleblower Program

- Single hotline for all ethics issues with an option for anonymity
- Dual dissemination of the information
- Protocols for timely investigation and reports
- Data security and retention policies
- Ongoing message to motivate employees and vendors to use the hotline
- Calls should not be answered or monitored by C-Suite



Culture is Everything

- No tolerance for unethical behavior is a tone at the top issue.
- Senior management and board need to lead by example.
- Education and training throughout the credit union both on the date of hire and at least annually.
- Code of conduct and ethics programs need to address and implement anti-retaliation measures so employees can trust the process.

Best Practices

- Create clear channels for communication such as: hotlines, anonymous email or websites, or use of third party.
- Protect confidentiality or anonymity of employees.
- Consider legal issues surrounding access to information for all parties.
- Give clear and consistent instructions on how to report compliance concerns.
- Remove any bias, misconceptions or preconceived ideas from inspection process.
- Ensure whistleblower program does not restrict employee's ability to report matters.
- Keep all parties informed of status and finding of the results of your investigation.





Benchmarking for Effectiveness

Consider how your whistleblower program collects and analyzes the following data:

- Number of calls/instances
- Average response time
- Number of substantiated findings
- Number of repeat reporters
- Location or branch calls are originating from

Role of the Audit



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Roles and Responsibilities

- Supervisory committees often serve as the hub of the various stakeholders in the financial reporting process.
- Regular communication with all parties is critical to the overall success and effectiveness of the audit committee.
- It's the sum of the parts.

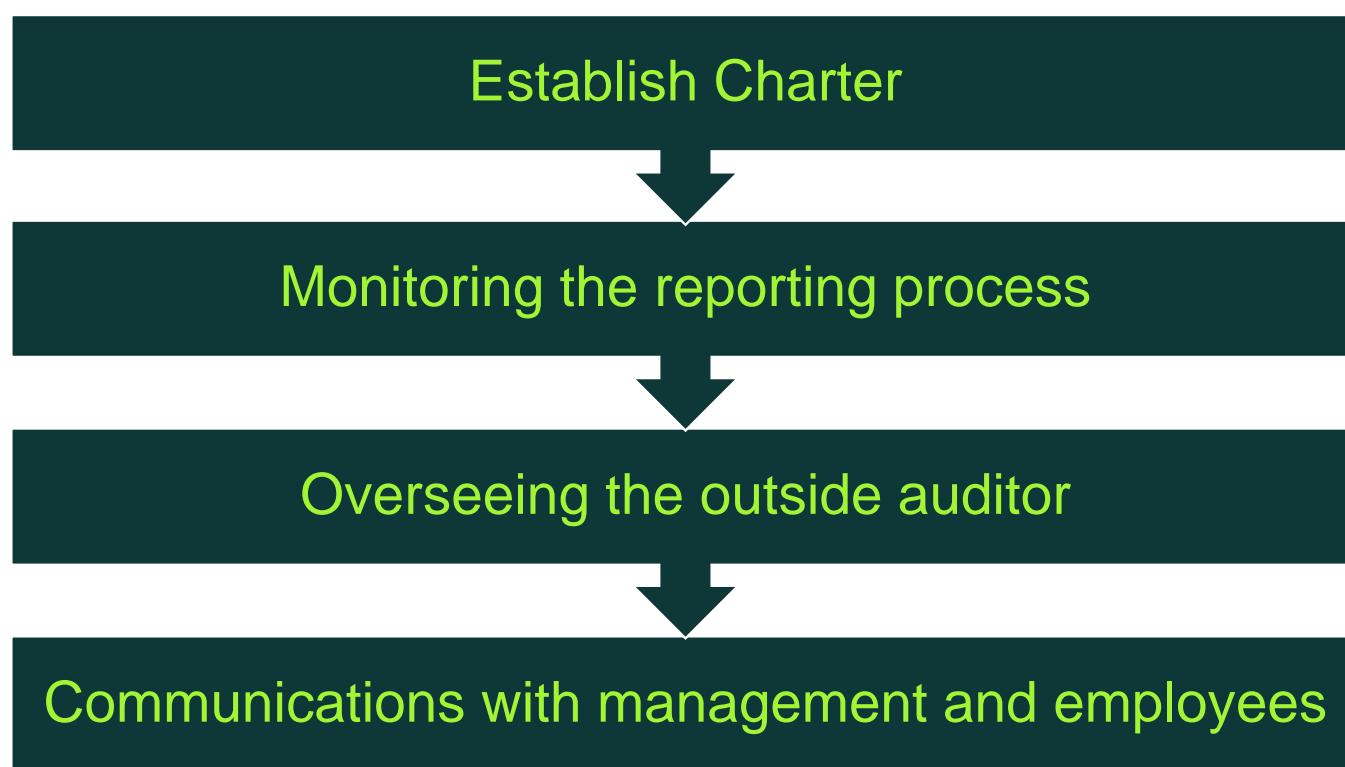


Roles and Responsibilities

Management	Board of Directors	Internal Auditors	External Auditors
<ul style="list-style-type: none">Primary responsibility for financial reporting process and for implementing controls to deter and detect fraud	<ul style="list-style-type: none">Responsible for the oversight of the business and control environment	<ul style="list-style-type: none">Evaluate the potential for occurrence of fraud and how the company manages fraud risk	<ul style="list-style-type: none">Obtain reasonable assurance the financial statements are free of material misstatement



Roles and Responsibilities



Roles and Responsibilities

Establishing A Charter

- NCUA Rules and Regulation and Federal Credit Union Act define the roles and responsibilities of the supervisory committee, including the adoption of a charter. The charter should contain only duties that the supervisory committee is required to perform under current regulations and any additional ones that the committee will actually perform such as its report to members at the annual meetings, attendance at board meetings, member verification, member complaints, work with internal audit, meetings with examiners, etc.



Roles and Responsibilities

Monitoring the Reporting Process

- Ensure proper internal controls are established.
- Be familiar with the company's risk assessment policies.
- Be informed of critical accounting choices for any kind of transaction or judgment decisions .
- Compliance with laws and regulations.
- Ensure an external audit is performed annually.



Roles and Responsibilities

Overseeing the Outside Auditor

- The Supervisory committee is directly responsible for the appointment, compensation, and oversight of the outside auditor.
- Supervisory committee members should ask the outside auditor to explain accounting principles and choices with industry standards, and ask why a particular methodology was chosen over another.



Roles and Responsibilities

Communications with Management and Employees

- Meet with executive officers on a regular basis.
- Should support positive tone at the top due to increased pressure on CEO's and CFO's.
- Regular and candid communications.
- Provide valuable input to the management team based on personal experience and insights without micromanaging.



Roles and Responsibilities

Communications with Management and Employees (Cont'd)

- Ensure that disclosure in the credit union's statements of financial condition and results of operations are balanced and fully responsive.
- Review the selection, application, and disclosure of critical accounting policies prior to finalizing annual reports.
- If uncertain about the application of specific generally accepted accounting principles, consult with the external auditors or other outside advisors.



Bringing Risk Oversight Up to Par

2011 studies published by Committee of Sponsoring Organizations indicate that many directors are still falling down on their risk oversight responsibilities.

70 percent of the over 200 corporate directors questioned thought that their boards were *“not formally executing mature and robust risk oversight processes”*.



Risk Management Oversight

- Financial risk can exist in the following areas:
 - Day-to-day activities
 - Changes in the economy
 - Demands of consumers and regulators
 - Information technology
 - New programs offered to members or where internal processes are not fully vetted



Risk Management Oversight (cont'd)

- Audit should ensure that a process to assess and monitor risk management performance is in place –
 - To address the effectiveness of committee structures and charters.
 - The level of board's understanding of risk policies.
 - The level of productivity of management and board communications.
- Direct board interaction with managers most acquainted with the organization's key risks.



Risk Management Oversight (cont'd)

- Know the extent to which management has established effective enterprise risk management.
- Be aware of and concur with the organization's risk appetite.
- Learn who is responsible for risk identification, assessment, and management throughout the organization: and meet periodically with those individuals.



Risk Management Oversight (cont'd)

- Discuss with management how risks, including fraud and IT risks, are identified and how those are assessed in regard to likelihood and impact.
- Understand supervisory committee, external auditor and internal audit's role and planned coverage and meet periodically.
- Review financial reporting risks, weight them against the organization's risk appetite, and discuss with management how effective the controls in place are to mitigate those risks.



Risk Management Oversight (cont'd)

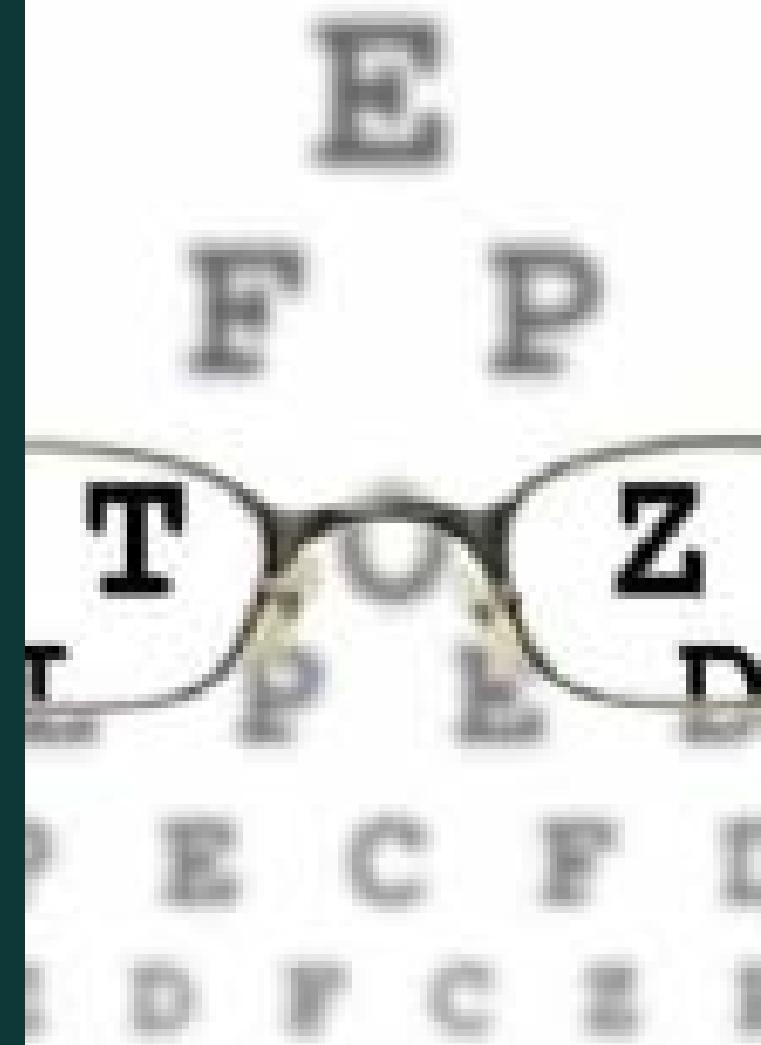
- Lack of time and/or expertise may prevent internal audit from effectively addressing IT risks.
- Ensure all Supervisory committee members are receiving the information needed in the appropriate format, so that effective evaluation of the risk management process can be made.
- Supervisory committee and board need to consider how to best align their oversight of IT.



Appendix A: Audit Committee Effectiveness



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Audit Committee Effectiveness

- Characteristics of effective audit committee members:
 - Willingness and ability to serve on the audit committee.
 - Experience as a CEO or CFO.
 - Diverse experience and skill sets.
 - Work with other committee members to plan membership and succession.



Audit Committee Effectiveness (cont'd)

- Characteristics of effective audit committee members:
(cont'd)
 - Obtain continuing education.
 - Meetings have an agenda or focus on important issues.
 - Use of self assessment process to improve performance.



Audit Committee Effectiveness (cont'd)

- Characteristics of effective audit committee members: (cont'd)
 - Thoughts on continuing education
 - Sessions with internal or external auditors on specific topics.
 - Computer based learning.
 - Use of other outside advisors.
 - Attendance at industry or regulatory events.



Audit Committee Effectiveness (cont'd)

“As companies reassess their strategies to adjust to the new business landscape, it’s important for boards and audit committees to insist on “self-reflection.”



*Source: “As Companies Weigh Growth Strategies, Audit Committees Sharpen Focus on Risks and Controls,” Mary Pat McCarthy, KPMG, September 2010, *Compliance Week**

Audit Committee Effectiveness (cont'd)

- Self Assessment Process
 - Formal evaluation within the board and audit committee.
 - Two way feedback from members of management, internal and external auditors.
 - Independent third party reviews.
 - Improvement in quality and timeliness of meeting materials.



Audit Committee Effectiveness (cont'd)

- Tips for improving effectiveness
 - Set agenda in advance and prioritize later.
 - Use consent agendas.
 - Make sure pre-reading is concise and directly relevant to planned discussions.
 - Cultivate the right mix of presentation and discussions.
 - Improve discussions by focusing on core assumptions not the outcomes alone.



Audit Committee Effectiveness (cont'd)

- Tips for improving effectiveness (cont'd)
 - Focus attention on the most important items.
 - Audit chair can delegate certain responsibilities to other members.
 - Brainstorm new agenda items at least annually.
 - Don't just add new agenda items, remove less relevant ones too.
 - Issue interim or business line reports to cover non-controversial and routine financial matters.



SUMMARY

- Audit committee members play a vital role in corporate governance given their oversight for the financial reporting process.
- Continuous monitoring and risk assessment process is needed to minimize risk of fraud.
- Open communication amongst members is key to long term success.



Audit Committee Fraud Tips

Evaluate management's assessment of fraud and mitigating controls.

Evaluate the internal auditor's testing of the effectiveness of each fraud control.

Evaluate how management has "set the tone from the top" to promote ethical behavior.

Communicate zero tolerance.

Evaluate the tests of detection of fraud used by your external auditors.



Audit Committee Fraud Tips

Ensure the internal audit function reports directly and candidly to you.

Ensure that internal auditors continually conduct tests to detect fraud.

Follow up on prior audit findings from the internal auditor, external auditor, and regulators.

Evaluate the nature and cause of finding.

Annual fraud policy signed by all employees.



Top 10 Questions Audit Committees Should Ask

1. What is the internal audit coverage of the organization's risk management and governance processes?
2. How responsive to change and flexible is internal audit's risk-based audit plan?
3. How does internal audit use technology to enhance its auditing and monitoring activities?
4. What is the strategic vision and plan for internal audit?
5. What perceived value does the organization receive from its internal audit activities?



Top 10 Questions Audit Committees Should Ask

6. How do we strengthen communications and relationships between internal audit and the audit committee?
7. How does internal audit ensure that its activities are in full compliance with “The International Standards for the Professional Practice of Internal Auditing?”
8. How does internal audit acquire and develop top talent for the organization?
9. What types and levels of training are conducted by internal audit?
10. Does internal audit have skill or staffing gaps and, if so, how are they being addressed?





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About Moss Adams

Financial Services

Reach

Of the nation's top 25 largest credit unions, we serve more than any other firm.



Credit Union Expertise

We have served credit unions for more than 35 years

- Our clients range from institutions with less than \$20 million to \$17 billion in assets.
- We're currently ranked in the top three for audit firms in terms of total credit union assets audited and top four in terms of the number of credit unions audited.
- We're currently ranked in the top ten for audit firms in terms of total credit union assets audited within the Central Region.
- Our professionals are actively involved with many credit union associations and continue year after year to contribute to the movement through active trade association involvement, speaking engagements, and training opportunities for credit union personnel, supervisory committees, and board members.



Value-Added Resources



Articles & Alerts

Industry-specific insight and important tax and assurance updates



Reports & Guides

A more in-depth look at significant changes and subjects across the accounting landscape



Webcasts

On-demand and live sessions with our professionals on technical and timely topics



Events

Seminars, destination conferences, networking receptions, and charity events, among others



Insights and Resources



GUIDE

CECL ACCOUNTING GUIDE



Download our guide, which serves as a practical and illustrative document to assist with CECL implementation efforts.

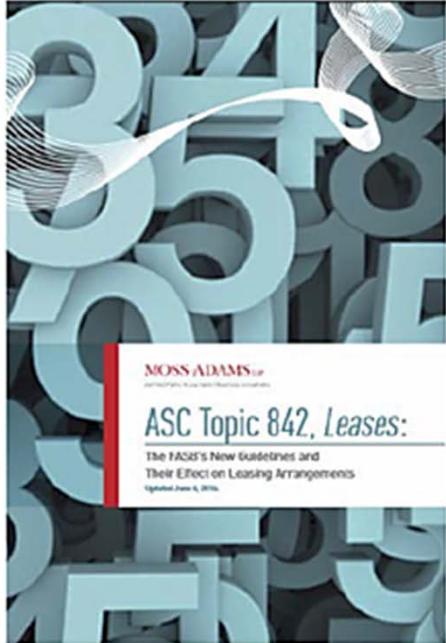


REPORT

CREDIT UNIONS INDEX REPORT



The Credit Union Index is a summary analysis of credit unions by state.



Industry Insights

- Accounting and tax updates
- Strategic growth opportunities
- Cybersecurity
- Digital transformation



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◀ 25+

locations west
of the Mississippi

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Phoenix

CALIFORNIA

Fresno

Los Angeles

Napa

Orange
County

Silicon Valley

Sacramento

San Diego

San Francisco

Santa Rosa

Stockton

Walnut Creek

COLORADO

Denver

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Eugene

Medford

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WASHINGTON

Bellingham

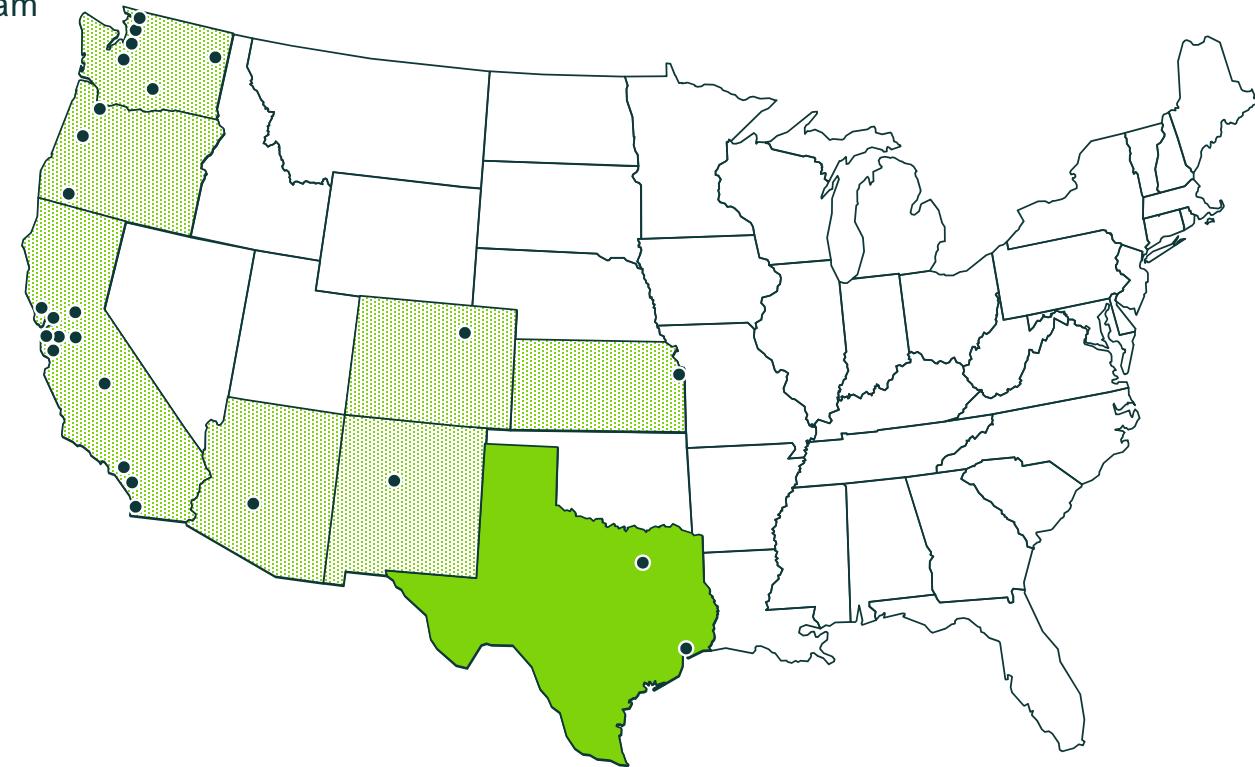
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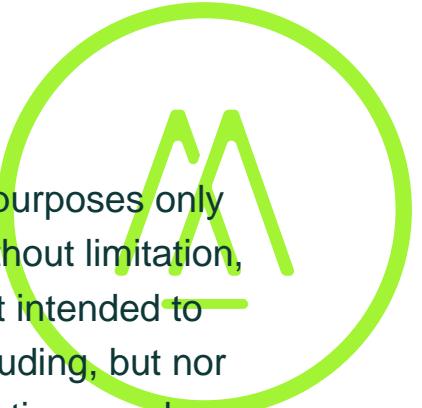
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