



Emerging Audit Trends

Presented by Steve Schiltz and Dean Rohne

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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Agenda

Discuss recent issues auditors should consider

Grants

Impact of
deposit
growth

Call Report
Modernization
(CRM) project

New lease
accounting
standard

CECL

Executive
compensation
plans

Limited
staffing

Review impact of items on internal audit plan



Polling Question 1

What is the level of asset growth over the last two years?

- A. Less than 10%
- B. 10% to 25%
- C. 25% to 50%
- D. Over 50%



Grants to Credit Unions

- U.S. Department of the Treasury has issued grant funds with for specific programs that a number of credit unions have participated in through the Community Development Financial Institutions (CDFI) Fund:
 - Financial Assistance Program
 - Rapid Response Program
 - Small Dollar Loan Program



Grants to Credit Unions

- Great way to assist the communities credit union serve, however:
 - Each grant agreement has requirements for receiving funds
 - If federal grant expenditures are more than \$750,000 in a year it triggers additional audit requirements



Grants to Credit Unions

Commonly referred to as a single audit (OMB Circular A-133)

In addition to audited financial statements also have report on:

- Opinion on compliance with OMB compliance requirements for reach major federal program
- Report on internal control over compliance
- Report on Schedule of Expenditures of Federal Awards Required by Uniform Guidance



Grants to Credit Unions

- Considerations outside of single audit requirements
 - Recommend reading each grant to understand specific compliance requirements
 - Rapid response program has ongoing compliance requirements outside of just single audit compliance such as:
 - Transaction level report
 - Performance progress report
 - Uses of award report
 - Annual certification report



Polling Question 2

With the growth at the credit union the internal audit department has changed as follows:

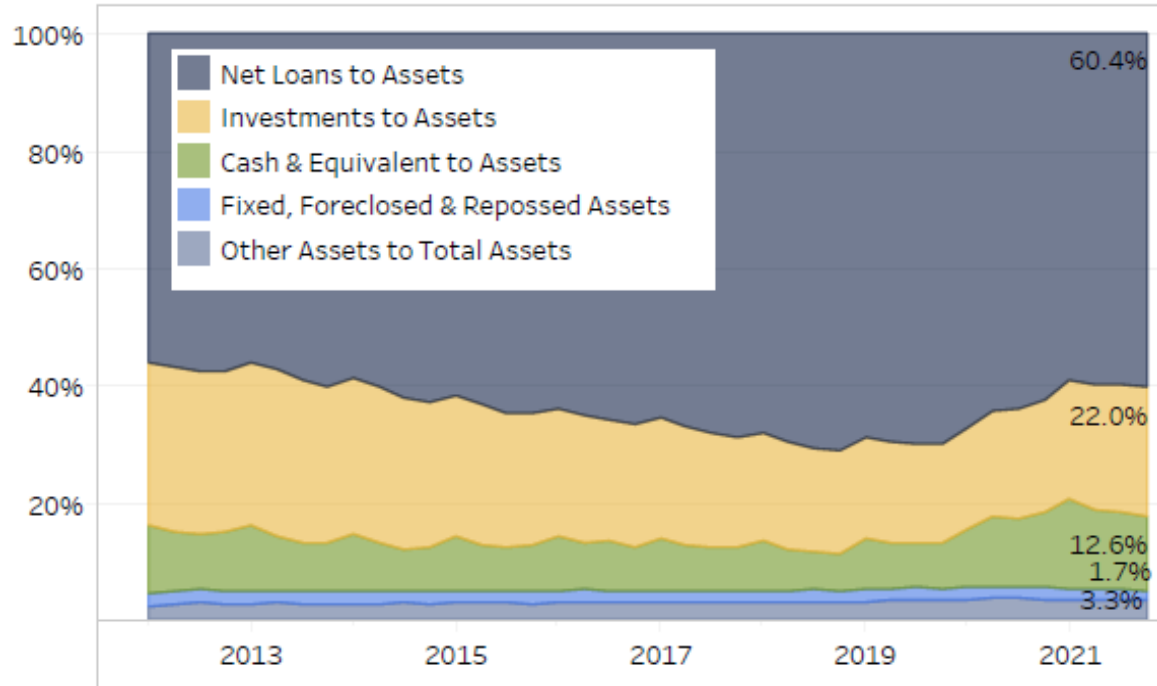
- A. Less staff
- B. No changes
- C. No changes, but additional outsourced audits
- D. Additional staff



Impact of Deposit Growth

Asset Distribution

(% of Total Assets)

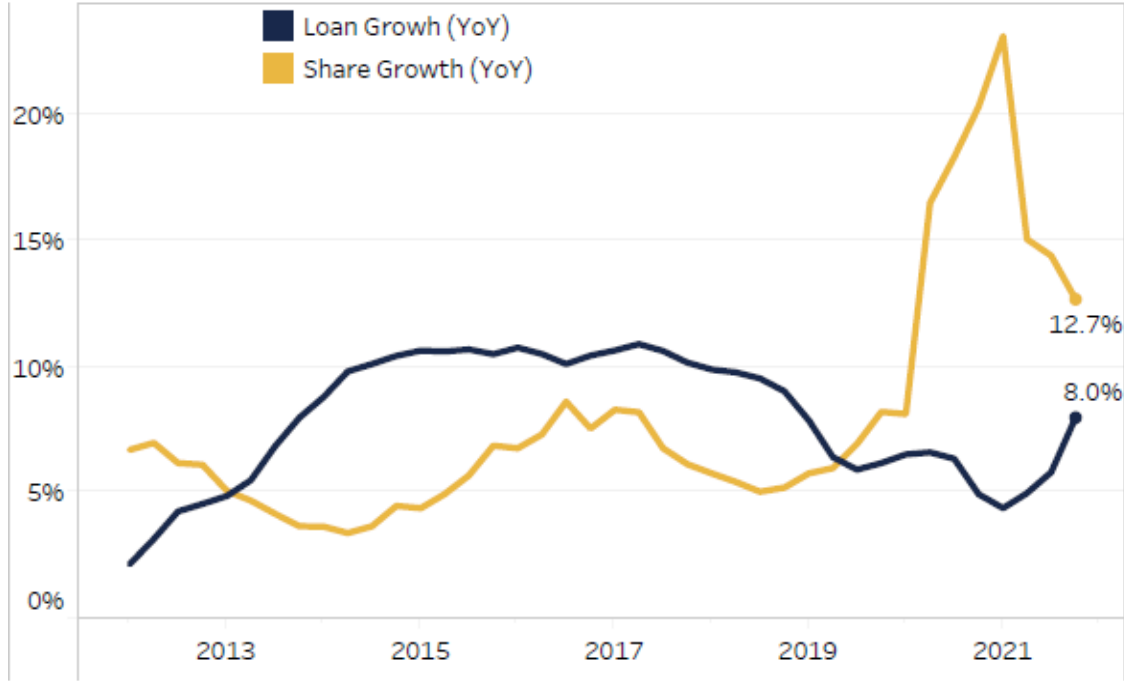


Source: NCUA
4th Quarter
Chart Pack



Impact of Deposit Growth

Loan Growth vs. Share Growth

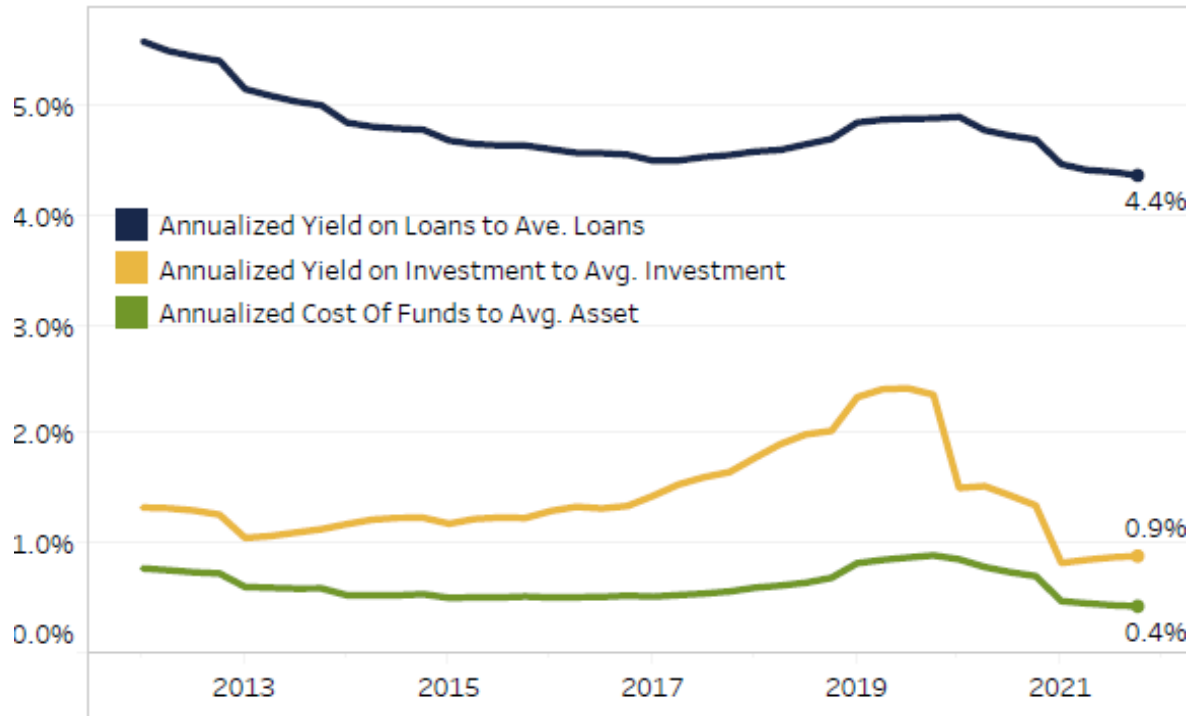


Source: NCUA
4th Quarter
Chart Pack



Impact of Deposit Growth

Yield vs. Cost of Funds

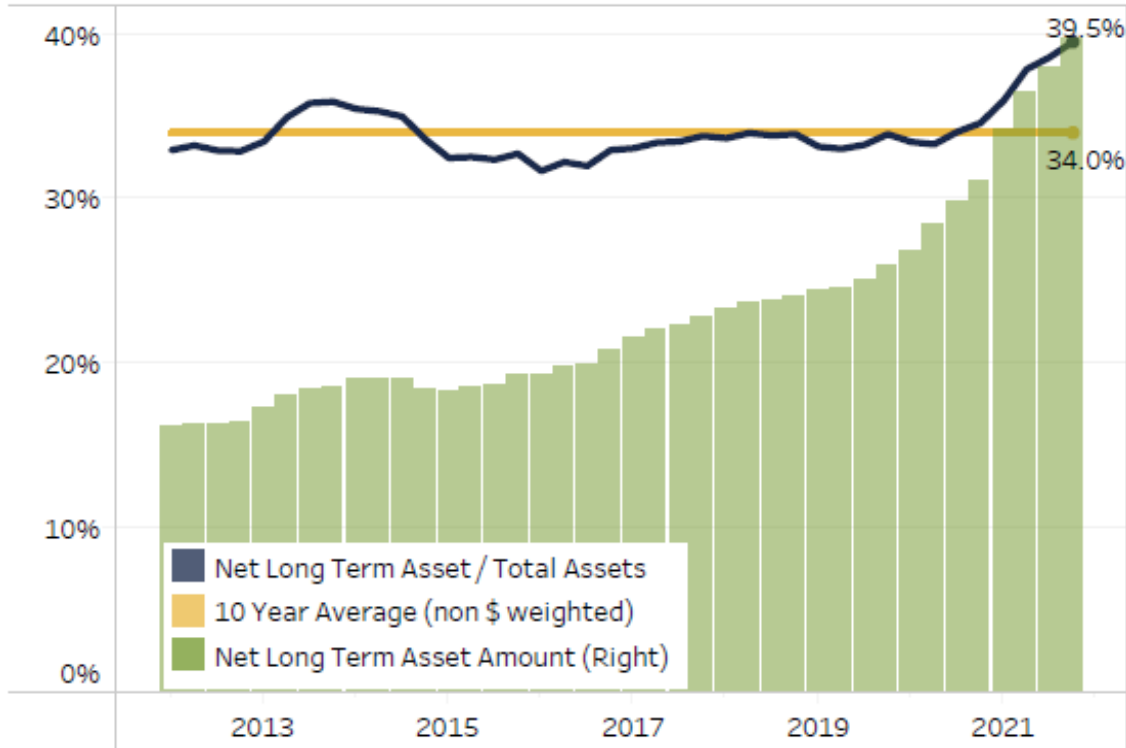


Source: NCUA
4th Quarter
Chart Pack



Impact of Deposit Growth

Net Long Term Assets / Total Assets



Source: NCUA
4th Quarter
Chart Pack



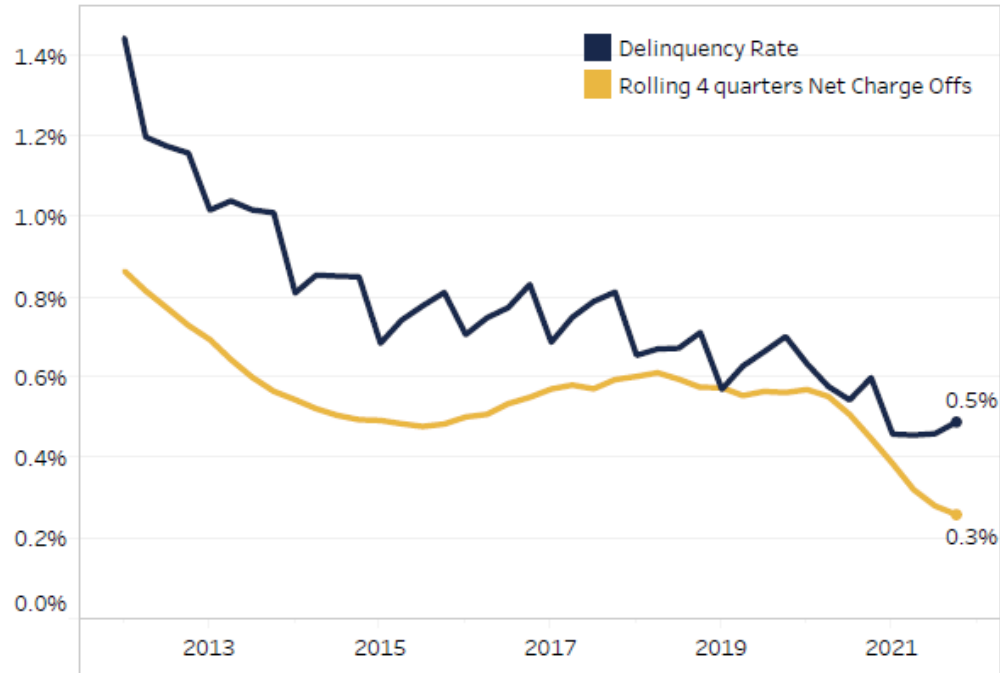
Impact of Deposit Growth

- Internal auditor considerations
 - How is credit union managing additional liquidity?
 - Complying with ALM policies
 - Risk profile consistent with plan
 - Is credit union getting more aggressive on lending
 - Is investment risk profile consistent with policy?
 - Types of investments
 - Time period of investment
 - Impact of unrealized losses on available for sale securities



Loan Quality

Delinquency & Annualized Net Charge-Offs

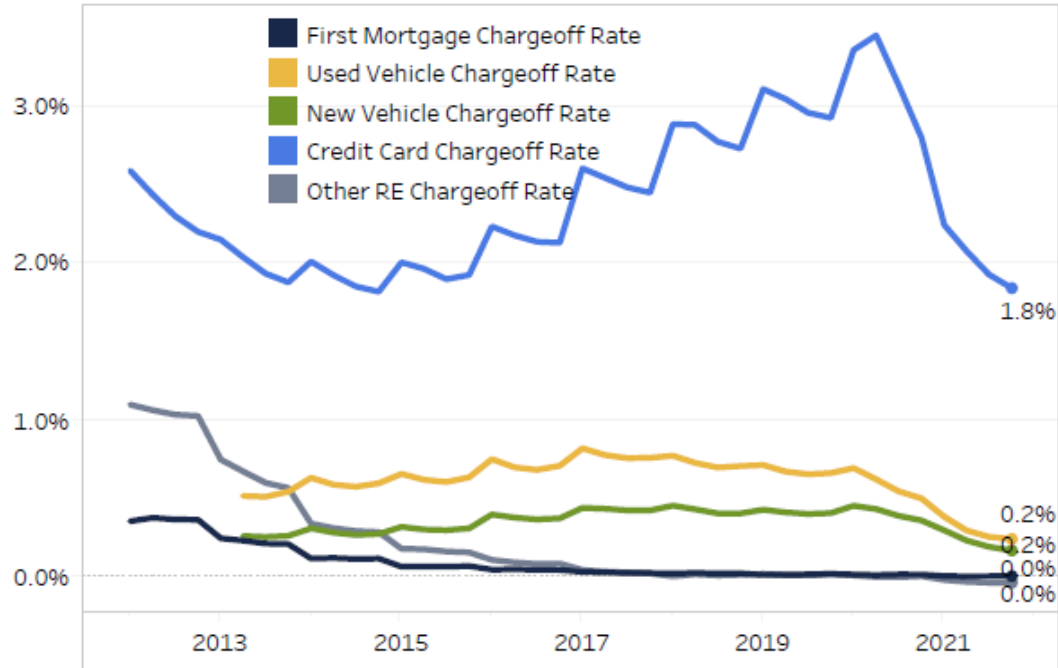


Source: NCUA
4th Quarter
Chart Pack



Loan Quality

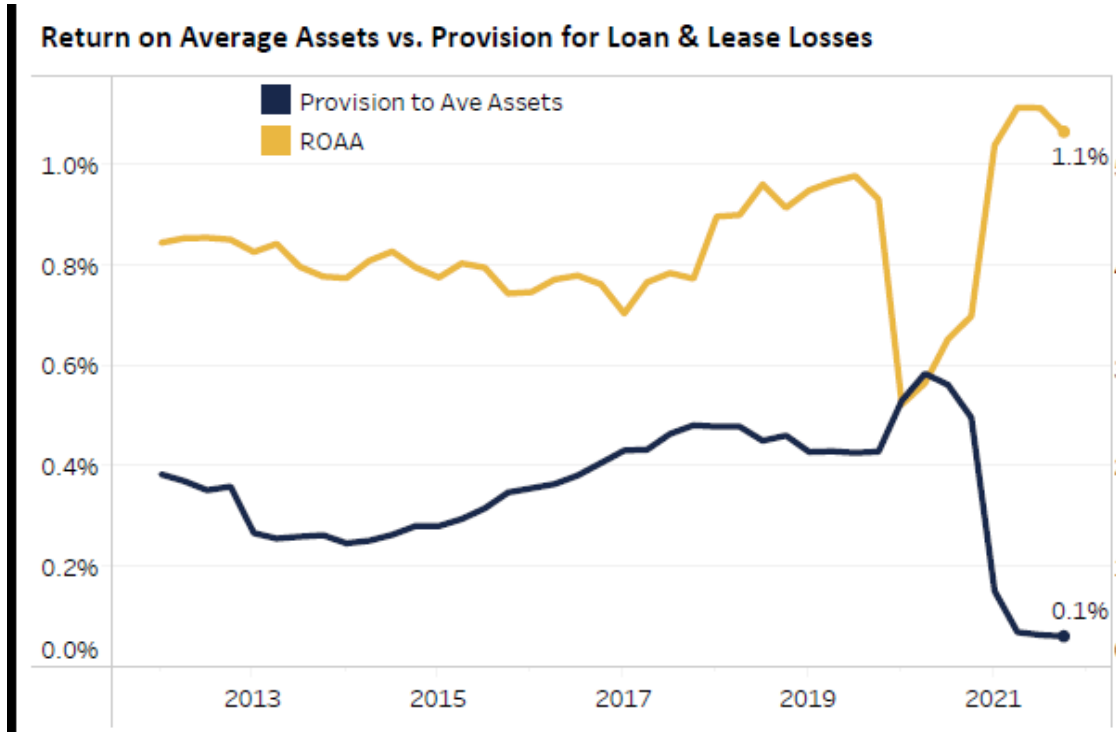
Loan Chargeoff Rate



Source: NCUA
4th Quarter
Chart Pack



Loan Quality

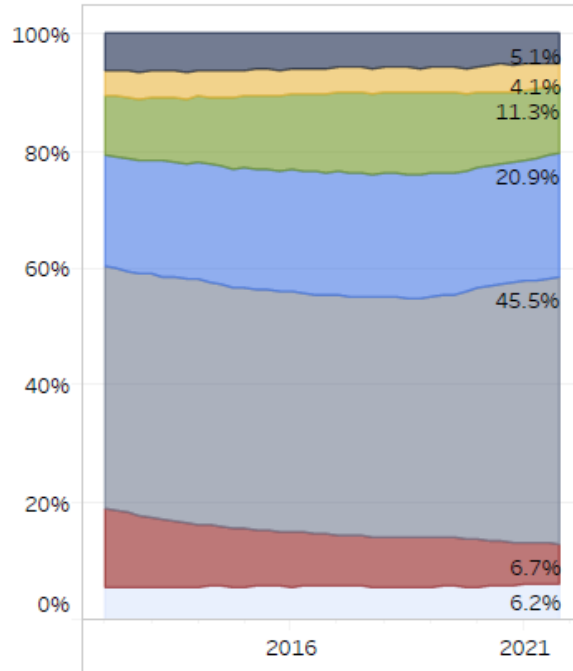


Source: NCUA
4th Quarter
Chart Pack

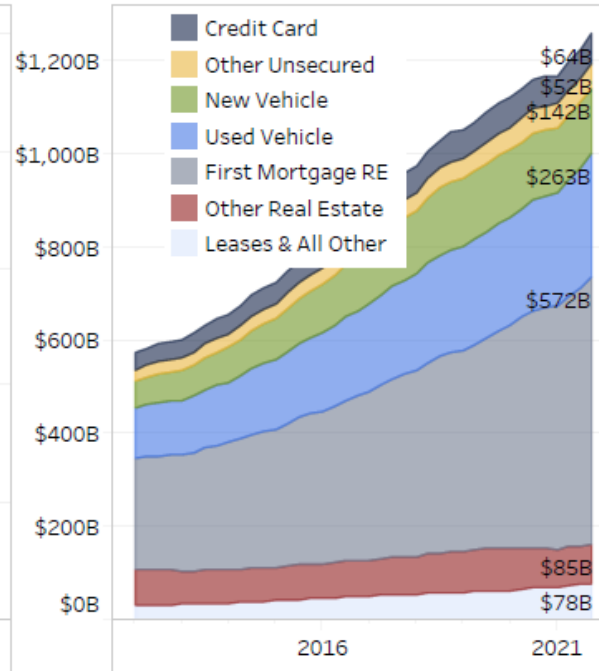


Loan Quality

Loan Distribution - Detail
(% of Total Loans)



Loan Distribution - Detail
(Billions)



Source: NCUA
4th Quarter
Chart Pack



CRM Project Overview

- NCUA conducted a comprehensive review of the call report beginning in 2016.
- Objectives include:
 - Streamline the call report process.
 - Reorganize and improve data collection.
 - Accommodate the new Risk-Based Capital (RBC) schedule (applies to credit unions greater than \$500 million in total assets).
- The call report was completely restructured beginning with the 3/31/22 call report cycle.



CRM Project Burden Reduction

Call Report: Total Fillable Account Codes

	December 2021 Call Report	March 2022 Call Report	% Change
Credit unions ≤ \$500 million in assets	920	750	-18%
Credit unions > \$500 Million in assets electing CCULR	920	769	-16%
Credit unions > \$500 Million in assets NOT electing CCULR	920	843	-8%



Call Report Changes Effective 3/31/22

- The new call report will contain two schedules (to be completed by all credit unions) and nine sub-schedules (to be completed only as applicable).
- The two required schedules include:
 - Statement of Financial Condition (Pages 1-3).
 - Statement of Income and Expense (Pages 4-5).



Sub-Schedules (Changes Effective 3/31/22)

A. Loans:

1. Loans
2. Delinquency
3. Charge-offs/Recoveries
4. Other Loan Info
5. Indirect Loans
6. Loan Purchases and Sales
7. Residential Real Estate
8. Commercial

B. Investments:

1. Supplemental Info for AFS and HTM Debt Securities
2. Supplemental Info for Trading Debt or Equity Securities
3. Investment Maturity Distribution
4. Investment Memoranda (includes employee benefit or deferred comp plans)



Sub-Schedules (Changes Effective 3/31/22)

- C. Commitments and Off-Balance Sheet Exposures:
 1. Unfunded Commitments
 2. Off-Balance Sheet Exposures
 3. Contingent Liabilities
 4. Borrowing Arrangements
 5. Borrowing Maturity Distribution
- D. Shares and Supplemental Info (# of Members, Maturities, Insured Savings Computation)
- E. Schedule E – Supplemental Info (Grants, Employees, Branches, International Remittances, CUSOs, MSBs)
- F. Schedule F – Derivatives
- G. Schedule G – Prompt Corrective Action
- H. Schedule H – CCULR Ratio
- I. Schedule I – RBC (5 pages)



Leases (ASC Topic 842)

- Requires all lease agreements greater than 12 months to be recognized on the statement of financial condition
- Homogeneous leases with similar terms can be evaluated collectively
- All right-of-use (ROU) assets, less accumulated amortization are reported with Other Fixed Assets (Page 2, Line 20)
- Lease liabilities are reported with Accounts Payable and Other Liabilities (Page 3, Line 1)
- Effective for fiscal years beginning after 12/15/21



Sample Lease Disclosure

The required minimum rental payments under the terms of these noncancelable leases at June 30, 2022, are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2023	\$ -
2024	-
2025	-
2026	-
2027	-
Thereafter	-
Total Undiscounted Lease Payments	-
Less Imputed Interest	-
Total Lease Liabilities	\$ -



CECL - The New Standard

What is the impact upon implementation?

- January 1, 2023 – (unless subject to an earlier implementation date or the credit union chooses to early adopt)
 - Adjustment is made to the allowance for loan and lease losses based on the impact of CECL in estimating the ALLL. The other side of the entry will be to undivided earnings.
 - March 31, 2023 call report will be filed utilizing CECL to estimate the ALLL
- After initial adoption
 - Future adjustments and initial recording will be recorded through earnings



CECL Model



Life of loan losses versus losses over the next operating cycle



Based on current, known factors and reasonable and supportable forecasts about the future



Concept – every loan originated increases exposure to credit risk



Contractual loan payments reduce this exposure



Transparency for financial statement users



CECL Overview

- Expected credit loss is an estimate of the present value of cash flows not expected to be collected based on quantitative and qualitative information such as:
 - Past events
 - Historical loss experience
 - Current conditions
 - Borrower credit worthiness
 - Forecasts of expected credit losses
 - Current point and forecast direction of economic cycle



CECL Thoughts

- Credit unions needs to maintain supportable data for Q&E factors.
- There will be increased volatility in the ALL due to changes in economic conditions given estimating the ALL under CECL over the life of the loans instead of the just the next reporting period.
- Overall, the expectation should be for increased amounts in the ALL when CECL is adopted.
- Consider ranges to consider in estimating the ALL.



Questions to Consider

Has management identified a methodology or approach?

Is the current method and CECL being run simultaneously to assess performance?

Can management explain how models function?

Have different scenarios been run to assess model performance?

Is there a process to support Q&E factors?



Executive Compensation and Incentive Plans

- Over the last few years a number of credit unions have implanted new executive compensation plans. The following are common plans:
 - 457(b) and 457 (f) deferred compensation plans
 - Collateral assignment split dollar life insurance plans
 - Employee incentive plans



Executive Compensation and Incentive Plans

- 457(b) and 457 (f) deferred compensation plans
 - 457(b) deferred compensation plan
 - Contributions are tax-deferred
 - Earnings on the funds are tax-deferred
 - Operates much like a 401(k) plan, with specific contribution limits
 - 457 (f) deferred compensation plan
 - Provides tax-exempt employer to supplement retirement income for select members of management
 - Easy to administer and earnings compound tax-deferred
 - Benefits become taxable upon vesting



Executive Compensation and Incentive Plans

- Collateral assignment split dollar life insurance plans
 - Credit union provides a loan to executive that is used to purchase a life insurance policy.
 - Policy is pledged as collateral on loan from the credit union.
 - Is generally designed to operate like a defined benefit pension plan.
 - Accounting can be complex based on how the details of the plan.



Executive Compensation and Incentive Plans

- Collateral assignment split dollar life insurance plans
 - General accounting considerations for the credit union
 - Recourse loan
 - Loan agreement indicates executive is responsible for any collateral short-fall if the loan is called for any reason
 - Executive has ability to repay any collateral shortfall
 - Loan is carried at the loan amount
 - Non-recourse loan
 - Loan agreement indicates executive is not responsible for any collateral short-fall if the loan is called for any reason
 - Loan is recorded at lower of cash surrender value or loan amount



Executive Compensation and Incentive Plans

- Employee incentive plans
 - Generally developed by management and approved by the board
 - Can be all or some of the following:
 - All employees
 - Only for management
 - Determined by department
 - Incentive based for various product sales



Executive Compensation and Incentive Plans

- Employee incentive plans
 - Key is to understand key controls of plan and where possibilities exist for abuse
 - Consider independence implications if internal audit also included
 - How significant is incentive compared to overall compensation



Polling Question 3

From an internal audit perspective what is the most significant risk facing the credit union?

- A. Ongoing limited staffing
- B. Information security risk
- C. Lack of addressing risk for new products
- D. Other



Impact of Limited Staffing

The following trends have occurred over the last couple years:

- Significant asset and deposit growth
- Unfilled positions resulting in limited staffing

Considerations:

- Are controls continuing to function?
 - Segregation of duties
 - Monitoring controls
- Are credit union staff adequately trained



Impact to Audit Plans

- Consider modifications to audit plan to address recent changes:
 - Impact of staffing shortages
 - Credit Union growth areas
 - Significant accounting standard changes
 - Changes in operations and compliance requirements
 - Items reported from outside parties
 - Financial statement audit
 - Third party auditors
 - Recent exams



Questions

Stephen J.M. Schiltz, CPA, Principal

520-352-1259

stephen.schiltz@CLAconnect.com

Dean Rohne, CPA, CIA, Principal

512-276-6048

dean.rohne@CLAconnect.com



[CLAconnect.com](https://www.CLAconnect.com)



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