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Title 46 - DEPARTMENT OF BANKING AND FINANCE

Chapter 11 - SUPERVISORY COMMITTEE'S ANNUAL AUDIT

001 Section 21-1791 of the Nebraska Credit Union Act says in part, "At the close of each year, the committee shall audit, or cause to be audited by an accountant approved by the Department of Banking and Finance, the books and records of the credit union...." The Supervisory Committee shall apply to the Department of Banking and Finance on forms prescribed by the Department at least 30 days prior to the engagement of services of an accountant. The minimum standards to be met by an accountant selected to perform the annual audit of a credit union and the minimum standards of the annual audit itself are as follows:

001.01 QUALIFICATION

001.01A The accountant or accounting firm must be a certified public accountant or public accountant. A certified public accountant or public accountant is deemed to be a person who is duly registered and is in good standing under the Public Accountancy Laws of Nebraska.

001.01B In the event the Supervisory Committee does not elect to provide for an annual audit by an accountant or an accounting firm, it must of itself make a thorough audit of the books, records, funds and securities held by the credit union. This audit must be conducted in accordance with the provisions of this rule. However, the Supervisory Committee may assign the performance of such a Supervisory Committee audit to one or more persons who may not necessarily be a member of such committee, provided, that the report compiled thereof is made in accordance with 46 NAC 11 of the Rules and Regulations of the Department of

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Banking and Finance and is verified as to its correctness and signed by a majority of the Supervisory Committee so attesting; provided further, that said report is made a part of the record of the credit union in accordance with Section 21-1791.

001.02 INDEPENDENCE

001.02A If the Supervisory Committee chooses to cause the books and records of the credit union to be audited, the audit, to be acceptable, must be completed by a qualified accountant or accounting firm who is in fact independent. An accountant or accounting firm, will not be considered to be independent, if he or she or any member of the accounting firm:

001.02A1 is connected with the credit union as an officer, committee member, director, attorney or employee;

001.02A2 is the beneficial owner, directly or indirectly, of 5% or more of the shares of the credit union;

001.02A3 is a borrower from the credit union;

001.02A4 makes entries or postings of the books of account or performs any other operating functions for the credit union;

001.02A5 or any partner or principal of the accounting firm receives any special consideration in any transaction with the credit union or has any interest, direct or indirect, financial or otherwise, in any real property owned by or securing any loan made by the credit union, or in any other operating activity or function of the institution; or has any substantial conflict of interest, or the appearance thereof, by reason of business or personal relationships with management or those individuals who are in a position to influence management or its decisions or functions.

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001.02B An accounting firm which has a member who is not considered independent shall exclude such accountant from any personal involvement in the audit.

~~001.02B~~ 001.02C The foregoing requirements are not to be construed as all inclusive criteria in judging the independence of an accountant or accounting firm, but rather as setting forth the most common conditions which contribute to a lack of independence. The certified public accountant or public accountant must adhere to the American Institute of Certified Public Accountants' rules for independence, unless further restricted by the rules or interpretations of the Department of Banking and Finance. It is the responsibility of an accountant or accounting firm to disclose to the Department of Banking and Finance any unusual relationships or affiliations which he or she or any member may have with the credit union, or any persons closely connected with the credit union, and to have resolved any questions as to his or her independence before proceeding with the engagement. The accountant or accounting firm, must state specifically in the report of audit or supervisory committee audit that he or she or the accounting firm has met the test of independence specified above and that he or she or the accounting firm is in fact independent.

## 002 APPLICABILITY OF RULE

002.01 If a Supervisory Committee elects to conduct the annual audit themselves, the scope and reporting procedures of this rule are also applicable.

## 003 STANDARDS FOR ACCEPTABILITY

003.01 An annual audit of a state chartered credit union must be made in accordance with the minimum audit procedures outlined in this rule to be acceptable. The Director of Banking and Finance has the responsibility to determine whether an audit is acceptable. The Director also has the authority to reject any audit which does not conform in all respects with prescribed requirements. If, at any time, it is found that the accountant or accounting firm has not followed recognized rules of ethics or

conduct, or has not met the minimum standards of the Department of Banking and Finance, the audit may be rejected. Any misstatement of facts or circumstances or any misrepresentation of any kind knowingly made may not only cause an audit to be rejected but may also form a basis for the temporary or permanent disqualification of the individual(s) or firm from conducting similar audits.

#### 004 SCOPE OF AUDIT

004.01 General - The audit procedures listed below are minimum procedures to be performed under provisions of Section 21-1791. They should not be construed as restrictive. Circumstances relating to individual engagements or situations encountered may make it necessary or desirable to expand certain procedures, apply alternate procedures, or extend audit procedures to other areas. The scheduling of the audit should be coordinated with the Department of Banking and Finance to avoid conflicts with the Department's examination. The audit shall include a review of the credit union's system of internal control and operating procedures and the report shall include comments and recommendations from this review.

#### 004.02 Minimum Audit Procedures

##### 004.02A Control:

004.02A1 Commence audit on a surprise basis. Assume control over all negotiable items and records to be examined until procedures have been completed.

##### 004.02B Cash, Cash Items, Clearings and Exchange:

04.02B1 Count cash on a test basis and reconcile to general ledger, examine cash items on a test basis and request confirmation of totals of clearing and exchanges. Determine the disposition of larger return items.

##### 004.02C Due From Banks:

004.02C1 Examine (or prepare if necessary) bank reconciliations with correspondent banks by

obtaining statements for several days beginning with the audit date, and on a test basis compare checks and drafts with the records of instruments issued. Also confirm the balance directly with the related banks.

004.02D Investments:

004.02D1 Total the securities ledgers, reconcile carrying values with applicable general ledger accounts, account for all securities by reviewing securities on hand and confirmation of those held by others. Review the investment portfolio to determine if all securities were purchased and/or being held in conformity with applicable statutes and regulations.

004.02D2 Review the method utilized by the credit union to determine the adequacy and/or need for an allowance for losses on investment account.

004.02E Loans:

004.02E1 Total the loan ledger cards or obtain a trial balance from the service center and prove totals on a test basis, or review the service center audit, and reconcile totals with applicable general ledger accounts. Examine loan documents for a representative number of each type of loan to determine if the terms conform to the credit union's loan policies and that they have accurately been entered into the computer if so applicable. See Section 009 for confirmation requirements.

004.02E2 On a test basis review selected individual loan accounts to determine the accuracy of interest calculations.

004.02E3 Review the method utilized by the credit union to determine the adequacy and contributions to the allowance for loan loss account.

004.02E4 Review the transfer to allocated reserves (including allowance for loan loss) to determine that all transfers were made in

accordance with the requirements of current applicable statutes and regulations.

004.02F Fixed Assets:

004.02F1 From the date of the prior audit, review transactions in the accounts, trace approval of major expenditures to the minutes of the Board of Directors' meetings and test the computation of depreciation.

004.02G Share Accounts:

004.02G1 Total regular share accounts individual ledgers or obtain trial balance from the service center and prove totals on a test basis, or review the service center audit, and reconcile totals with general ledger accounts. Trace disposition of selected unposted items. See Section 009 for confirmation requirements.

004.02G2 Total share drafts account individual ledgers or obtain trial balance from the service center and prove totals on a test basis, or review the service center audit, and reconcile totals with general ledger accounts. Trace disposition of selected unposted items. See Section 009 for confirmation requirements.

004.02G3 Total the time deposit accounts or obtain trial balance from the service center and prove totals on a test basis, or review the service center audit, and reconcile totals with general ledger accounts. Trace disposition of selected unposted items. See Section 009 for confirmation requirements.

004.02G4 On a test basis, review selected individual share accounts to determine the accuracy of interest calculations.

004.02H Income and Expense:

004.02H1 Test selected entries to both income and expense accounts by reviewing proper documentation for selected items. Ascertain on a test basis by some independent means that all "debits" and

"credits" to the income and expense accounts have been recorded and have not been either understated or overstated. Review the related accounts of accrued income, accrued expenses, unearned discounts and deferred income by testing "debits" and "credits" as above; also ascertain that the balances in these accounts are fairly stated.

004.02I U.S. Savings Bonds, Travelers Checks and Other Consigned Items:

004.02I1 Examine credit union's most recent reconciliation of items on hand with memo controls and related confirmation from issuing agents, or, if such records are not available, count items on hand; reconcile with total on consignment, and obtain confirmation from issuers.

005 Internal Controls - The credit union's system of internal controls and operating procedures shall be reviewed, and the report shall include comments and recommendations from this review.

005.01 General:

005.01A Review accounting procedures for handling nonledger assets, such as charged-off loans, recoveries, etc.

005.01B Review minutes of Board of Directors, Supervisory and Credit Committees, and latest report of supervisory examiners, trace authorities for dividends declared and transfers to reserves.

006 Reporting:

006.01 A report shall be prepared and submitted to the Board of Directors describing the scope of the audit and by setting forth the findings and recommendations as a result of the auditing procedures performed and review of the credit union's operating procedures and system of internal control. Any open or unreconciled item at the time the report is submitted to the Board of Directors shall be disclosed and commented upon in the report. The report shall include the effective date of the audit, the

starting and closing dates of the audit and a statement that the minimum requirements outlined in this rule were met. The report shall include a balance sheet listing of the credit union's assets, liability, and capital, including the balance of the general ledger asset and liability accounts examined as of the audit date under the specific account headings. A description of procedures followed, including those applied to the income and expense accounts, is to be a part of the report.

006.02 The Supervisory Committee must file two copies of the report with the Department of Banking and Finance within 90 days from the starting date of the audit, or authorize the accountant or accounting firm performing the audit to file two copies of the report with the Department of Banking and Finance within 90 days from the starting date of the audit. Any defalcation discovered during the audit shall be reported to the Department of Banking and Finance immediately by the Supervisory Committee. In the event the Supervisory Committee does not report the defalcation immediately, the accountant or accounting firm performing the audit must report the defalcation immediately. The accountant or accounting firm conducting the audit should have the credit union authorize him or her in advance of his or her audit to notify the Department of Banking and Finance of discovered defalcations.

007 Board of Directors' Responsibilities: The condition of a credit union depends largely upon the quality of leadership supplied by the Directors. This means the Board must be kept informed of the affairs of the credit union and give direction. The proper supervision of the affairs of a credit union requires that Directors keep themselves well posted. Accordingly, the Board may not delegate responsibility for its duties, but may assign the performance thereof. Any areas not fully covered by the accountant's or accounting firm's report shall be performed by the Board itself. Although the Board as a group may not be qualified to perform the more technical aspects of a credit union audit, it should be possible for the Board to satisfy itself as to the following:

007.01 The soundness and authenticity of the credit union's loans and its loan policies.

007.02 That investment policies are being adhered to.



OCT 19 1938

007.03 The adequacy of the insurance and surety coverage.

007.04 That income, expenses and dividends are proper and legitimate.

Copies of the audit report prepared by an independent accountant or accounting firms, should be carefully reviewed and there should be a thorough understanding of the significance of all the details included therein.

008 Supervisory Committee's Responsibilities:

008.01 The responsibilities of the Supervisory Committee closely parallel the responsibilities stated in Section 007 for the Board of Directors. If an independent audit is to be performed, the Supervisory Committee has the obligation to assure its compliance with the regulation. The Supervisory Committee shall further follow the recommendations of this annual audit when it makes its quarterly inspections. Deficient areas of operation are to be corrected to the satisfaction of the Supervisory Committee and the Board of Directors or the Supervisory Committee is charged by the statutes to proceed with suspension proceeding.

009 Direct Confirmation with Borrowers and Depositors

009.01 The method of prescribing for the verification of accounts in connection with the annual audit is not to be construed as being a requirement in conjunction with the actual annual audit. The method is deemed appropriate whether used by the Supervisory Committee or an authorized accountant or accounting firm, during the quarterly inspections, referred to in Rule 46 NAC 10 or the annual audits referred to in this rule.

009.01A Prepare and mail confirmation requests on all loan and deposit categories, including participation loans purchased and sold.

009.01B For participation loans purchased, confirm balances with the selling credit union only. For participating loans sold, confirm the balances sold

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with the purchasing credit union and the total balances with the borrower.

009.01C Mail confirmation requests to a selected number of members whose loans were charged-off since the last audit.

009.01D Mail confirmation requests for all that are dormant, for a selected number of those accounts and have zero balances and have been closed since the last audit.

009.01E Confirmations returned as undeliverable or with exceptions and non-replies to positive confirmation requests should be followed up by review of underlying documents, subsequent activity or other appropriate procedures.

009.01F List names of account holders not responding to positive confirmation requests and also describe the procedures followed to determine the accuracy of these accounts.

009.01G All verifications must show a return address other than the normal mailing address of the subject credit union.

009.01H A report of the results of the verifications is to be made to the Department of Banking and Finance and to the Board of Directors of the subject credit union within 90 days from the issuance of the verifications if 100% of the accounts are verified. A similar report is to be made within 30 days if a lesser percent of the accounts are verified. Submit confirmation statistics summary showing the extent and results of the type of confirmation and type of account rather than report the extent and results of such procedures under each specific account heading in the body of report. Any accounts selected for confirmation which have not been or cannot be mailed or delivered to the customer must be so listed in the final report.

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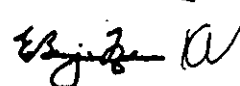
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