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Credit Union Chair – By E-mail

18 September 2018

Re: 2018 Financial Year-End

Dear Chair,

In preparing the 2018 annual accounts, the Central Bank ("the Bank") expects boards of directors to comply with the requirements of the Credit Union Act, 1997 ("the 1997 Act") and ensure that financial statements are in compliance with Financial Reporting Standard FRS102. Summarised below are some of the key areas for consideration by the board of directors regarding the 2018 annual accounts process.

Systems of Control in Credit Unions

The 1997 Act sets out the responsibilities of boards of directors and the manager with regard to systems of control. A comprehensive internal control system[1] is critical for credit unions to meet legislative requirements and to achieve their goals. The annual accounts process is an opportunity for boards of directors to review the internal controls environment.

Section 76H of the 1997 Act *inter alia* requires credit unions to ensure that its management information systems produce reports that are accurate, reliable, consistent and timely. This enables the board of directors and the management team to direct, control and manage the credit union's business efficiently and effectively and to provide accurate information to the Bank on a timely basis as and when required.

[1] Controls include but are not limited to physical controls, approvals and authorisations, verifications and reconciliations.

The board of directors and management of the credit union are responsible for establishing an effective internal control framework and for monitoring the systems and controls on an ongoing basis. In assessing the systems of control, the board of directors and management should ensure that the following are included:

- Policies and procedures are comprehensive and documented;
- Proper accounting records are maintained for all transactions; and
- There is effective segregation of duties, with no one person having end-to-end control for a process or an activity. In particular, credit unions need to ensure that there is appropriate oversight where officers have broad spans of control.

A key component of the systems of control includes regular reconciliations (at least monthly) of all balance sheet items / accounts. All balance sheet items / accounts should be reviewed and approved by persons independent of the preparer of the reconciliations.

Where material non-reconciling items are identified in the balance sheet, these should be reported promptly to the board of directors and a plan of action put in place to resolve the issues. Where material non-reconciling items remain, and / or prevent the preparation of accurate returns or accounts, the board of directors should report the matter promptly to the internal audit function, the external auditor and to the Bank.

If the board of directors or management becomes aware of any actual or potential material misappropriation of credit union funds, this should be reported promptly to the Bank. In addition, the credit union should consider the circular issued on 17 September 2018 in relation to Accrued Interest on Top-Up Loans.

Credit unions that do not comply with the legislative requirements in relation to systems of control and management information systems may be subject to the Bank's Enforcement and Administrative Sanctions Regime.

Financial Performance / Viability

The board of directors are reminded of their responsibility to prepare, monitor the implementation and review the strategy of the credit union under sections 55(1) and 76A of the 1997 Act. This includes a strategic plan, the targets and criteria for assessing performance of the credit union and financial projections. The financial projections should include detailed financial analysis and assumptions and the funding strategy proposed to support the balance sheet structure.

The annual audited accounts process provides an opportunity for the board of directors to assess performance against the strategic plan, consider operational efficiencies and to review the credit unions cost structures and competitiveness.

A priority focus for the board of directors should be the underlying performance and viability of the credit union. It is the Bank's expectation that the credit union's financial projections should be achievable, reflect risks and challenges and include a range of financial scenarios including stressed outcomes. A component of the strategic plan review process should be to assess the potential impact of increasing member savings on the balance sheet, particularly where the credit union has a low loan to asset ratio. Where the board of directors identify viability issues, these issues should form part of, and be reflected in, the strategic plan.

In assessing the financial performance of credit unions, the board of directors need to be cognisant of the impact of material and exceptional gains on investments, write back of loan provisions, property revaluation and changes in loan and investment product mixes, which may distort the underlying trading performance of the credit union.

The board of directors need to consider a range of financial ratios in assessing trading performance e.g. loan to assets, cost / income, and return on assets[2]. If the underlying financial performance discloses decreasing surpluses or deficits and / or the financial projections show deficits, the board of directors need to assess the credit unions ability to continue as a going concern. In these

[2] Return on Assets is an indicator of how profitable a credit union is relative to assets employed. It is calculated as net income divided by total assets.

circumstances, the board of directors need to consider and document alternative strategies to protect the credit unions capital and members' funds. Such considerations may include setting trigger points for alternative strategies.

Provisioning Guidelines

FRS102 requires that loans be assessed for impairment at the end of each reporting period. The board of directors are reminded that the Bank issued Provisioning Guidelines for Credit Unions[3] in April 2018. The objective of the guidelines is to ensure that the credit union has an appropriate provisioning framework in place. The board of directors are strongly encouraged to apply these guidelines in the development and application of such a framework for the credit union.

The provisioning guidelines outline the policies and procedures, which credit unions should adopt to support the development and implementation of an appropriate provisioning framework. Such a framework should reflect the nature, scale, complexity and risk profile of the credit union, whilst ensuring that the level of provisions held for loans is adequate.

Credit unions must ensure that they comply with all relevant accounting standards and should discuss the credit union's approach to provisioning with their auditors. The guidelines sets out the Bank's expectations on:

- Provisioning policy;
- Roles and responsibilities in relation to provisioning; and
- Income recognition on loans in default or loans written off.

The guidelines are not intended to replace or over-ride the requirements of FRS102.

The Prudential Return Guidance Notes have been updated to reflect the provisioning guidelines and they will be available on the Online Reporting System ("ONR") for credit unions to download in the 30 September 2018 Prudential Return area within ONR.

[3] Provisioning Guidelines for Credit Unions, issued in April 2018 https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/credit-unions/credit-union-handbook/provisioning-guidelines-for-credit-unions.pdf

Investments

The board of directors are reminded of the changes to the investment framework as outlined in the Credit Union Act 1997 (Regulatory Requirements) (Amended) Regulations 2018. The following EUR denominated classes of investments have been added to the investment framework:

- Supranational bonds;
- Corporate bonds; and
- Investment in Tier 3 Approved Housing bodies through a regulated investment vehicle.

From a review of the 2017 annual audited accounts, the Bank noted inconsistencies between classifications of basic and complex financial instruments, which has an impact on investment valuations i.e. fair value versus amortised cost.

In preparing the 2018 annual audited accounts, the board of directors need to ensure that they comply with FRS102 with regards to classification of investments.

Draft Financial Statements

Credit unions are required to submit the Draft Financial Statements return in template format via ONR in advance of their finalisation as part of the 2018 year-end process. Where necessary, a credit union may also be required to submit the draft annual accounts in PDF format. Supervisors will follow up directly with individual credit unions on any issues arising as required, including timelines.

Annual Return

The Annual PCF Confirmation section of the Annual Return has been amended to reflect the introduction of three new Pre-approval Controlled Functions (“PCFs”) from 1 July 2018 for credit unions with total assets of at least €100 million; reference to the new PCFs has been included in the relevant declaration and the Year-End Guidance Notes have been updated to reflect this. The updated Year-End Guidance Notes will be available for credit unions to download in the 30 September 2018 Annual Return area within ONR.

For information, key statutory reporting dates / deadlines for the 2018 year-end process are attached at Appendix 1.

Expectations for 2018 Year-End

The Bank expects the board of directors and management of credit unions to take cognisance of the issues highlighted in this letter in preparing their 2018 annual audited accounts.

If you have any questions on the foregoing, please contact your Supervisor in the Registry of Credit Unions directly.

Yours faithfully,

David Kielty
Deputy Registrar of Credit Unions

Appendix 1 – Statutory Notifications to the Central Bank of Ireland

Pursuant to Sections 22 and 23 of the Central Bank (Supervision and Enforcement) Act 2013, credit unions are required to submit the following via the Online Reporting System:

- ***Draft Financial Statements*** to be submitted prior to setting a date for the AGM;
- ***AGM Notification*** minimum of 7 and maximum of 21 days before the AGM;
- ***Final Financial Statements*** by 31 March 2019;
- ***Annual Audited Accounts*** by 31 March 2019;
- ***Annual Return*** by 31 March 2019;
- ***Change of Auditor***; in accordance with Section 117 of the Credit Union Act, 1997, a resolution at an AGM to change the auditor shall not be effective unless prior notice of the resolution has been provided to the credit union and the Bank not less than 28 days before the AGM; and
- ***Annual Compliance Statement***: in accordance with Section 66C of the Credit Union Act, 1997 credit unions are required to submit an Annual Compliance Statement by 30 November 2018.