



Banc Ceannais na hÉireann  
Central Bank of Ireland

Eurosystem

**Credit Union Chair**  
**By E-Mail**

18 September 2014

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**Re: Credit Union Financial Year End 30 September 2014 – Year End Approach**

Dear Chair

The financial and operational environment for credit unions continues to be very challenging in 2014. Continued loan book contraction remains a significant cause of concern. As operating costs continue to rise, the pressure on net margins from falling loan interest income and declining investments returns has continued.

The new requirements of the Credit Union Act 1997 (“the 1997 Act”) are designed to strengthen governance and the internal controls in credit unions. While boards of directors and managers have been focused on the implementation and embedding of the new regulatory framework, the requirement that all credit unions must have comprehensive strategic plans in place, has assisted some boards in highlighting challenges relating to on-going viability and the sustainability of their core business model. The embedding of the new functional roles of compliance officer, risk management officer and internal audit, which should be adequately resourced with experienced persons, which are intended to support boards and management in discharging their fiduciary duties and responsibilities to credit union members.

Adequate reserves are a key to the financial stability of credit unions in supporting their operations and providing a base for future growth and protection against the risk of unforeseen losses, as well as protecting members’ savings. The Regulatory Reserve Ratio sets out the minimum reserve requirement of each credit union. However, credit unions are expected to operate with a level of reserves above the regulatory minimum. It is for the board of directors of each credit union to decide on the amount of reserves to hold in excess of the minimum



requirement, taking account of the scale and complexity of the credit union's business, its risk profile and prevailing market conditions. Any decision in relation to proposed distributions in 2014 must be underpinned by these principles and by a prudent distribution policy.

In preparing the 2014 annual accounts we expect directors of credit unions to comply with all legislative and regulatory requirements and guidance issued by this office. We set out below the key areas on which boards of directors should focus on for the 2014 year-end.

### **1. Regulatory Reserve Ratio**

Credit unions are reminded of the requirements of the "*Regulatory Reserve Ratio for Credit Unions<sup>1</sup>*" (August 2009).

Where a credit union reports a surplus for the year but the Regulatory Reserve Ratio is less than 10 per cent, or would be less than 10 per cent following payment of a dividend, the credit union must make a submission to this office if it proposes to pay a dividend.

Any credit union that reports a deficit for the year cannot pay a dividend. However, in certain exceptional circumstances this requirement may be reviewed.

For example, where a credit union reports a deficit but has a Regulatory Reserve Ratio of more than 10 per cent it may be appropriate to pay a nominal dividend. In this regard credit unions may wish to make a submission to this office.

Credit unions that are required to make a submission in relation to the payment of a dividend should not set a date for their Annual General Meeting and should not print the annual accounts for circulation to members until agreement has been reached with this office.

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<sup>2</sup> Regulatory Reserve Ratio for Credit Unions – August 2009: available at [www.centralbank.ie](http://www.centralbank.ie) in the Credit Union Handbook chapter on Reserves.



In order to facilitate a smooth and timely process, credit unions should submit their proposals to this office as early as possible. All proposals must be accompanied by the information contained in Appendix 2.

## **2. Loan Provisioning**

We are requesting credit union auditors, as part of the year-end audit, to place particular emphasis on the adequacy of the bad and doubtful debt provisions in the 2014 accounts. It is vital that credit unions maintain adequate levels of overall reserves and provisions to ensure they remain financially stable. Credit unions are reminded that they must undertake a full review of the bad debts provisions, including provisions held against rescheduled loans, as part of the year-end accounts preparation and audit process<sup>2</sup>.

Credit unions are also reminded of the obligations to implement the requirements of the European Communities (Consumer Credit Agreements) Regulations 2010 (“the Regulations”) (Prudent Lending Standards) in the assessment of borrower’s creditworthiness. In assessing a borrower’s creditworthiness credit unions should:

- (a) Apply prudent lending standards to the granting of all new loans or top-ups of existing loans and
- (b) Have systems in place to ensure that such applications are fully assessed to confirm the borrower’s ability to repay the loan. In this regard, credit unions must satisfy themselves that they are fully apprised of the borrower’s financial position before granting a loan.

We expect directors of credit unions to apply a conservative and realistic approach in the measurement of bad debt provisions. Directors should take into consideration the level of risk inherent in the loan book, being mindful of the current economic and financial environment including the potential impact of the Personal Insolvency Act 2012.



Credit unions should be aware of the findings contained in the “*Credit Union PRISM Risk Assessments Supervisory Commentary*” (May 2014)<sup>3</sup>, which identified weaknesses in lending, credit control and credit risk management standards and practices in many credit unions.

In determining the level of bad and doubtful debt provisions, the board of directors must be mindful that practices relating to loan rescheduling, temporary loan arrangements, top-up loans, single/lump sum repayment loans, interest only loans, share to loan transfers and loans to connected borrowers can have the effect of understating provisions which must be avoided.

As part of the quarterly and year end loan book reviews process, credit unions in assessing the adequacy of loan provisions should undertake a detailed review of top-up type lending where the overall level of individual member debt over a period of time remains broadly unchanged or is increasing. Credit unions should be mindful that excessive top up type lending to members can have the effect of solidifying member’s core debt and where there is evidence of such trends, adequate provisions consistent with the increased risk profile should be made against such loans. Credit unions should ensure that loan book reviews are available to their auditors (internal and external auditors).

The board of directors should discuss the credit union’s provisioning policy with their auditors prior to finalisation of the annual accounts for 2014.

### **3. Liquidity and Investments**

Credit unions need to continue to maintain adequate levels of liquidity for their own particular circumstances and must comply with all legislative and other regulatory requirements issued by this office. In assessing the adequacy of liquidity this should be consistent with the credit unions risk appetite taking account the funding profile of the balance sheet, in particular members’ savings profiles and other issues to determine an adequate buffer calculated to avoid inadvertent breaches of the minimum regulatory liquidity requirements.

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<sup>3</sup>Available at [www.centralbank.ie](http://www.centralbank.ie)



In developing the risk appetite credit unions need ensure that it is consistent with the circulars on the *Guidance Note for Credit Unions on Matters Relating to Accounting for Investments and Distribution* (April 2009), “*Credit Union Liquidity and Investments*” (February 2011), “*Guidance Note on Investments by Credit Unions*” (June 2011), and the “*Amendment to the Guidance Note on Investments by Credit Unions, October 2006*” (February 2013) “*Investments in State Securities (other than Irish State Securities)*”(December 2013).<sup>4</sup>

In particular, directors of credit unions are required to ensure that the accounting treatment for investments complies with the relevant requirements of the 1997 Act and are in accordance with the Guidance Note relating to the valuation of investments and that the distribution policy is appropriate and prudent.

Credit unions are reminded that, in accordance with the June 2011 circular on “*Guidance Note on Investments by Credit Unions,*” investments in a single institution should not exceed 25 per cent of the total value of a credit union’s investment portfolio.

#### **4. Impairment of Fixed Assets**

It is of concern that a number of credit unions have non-income generating assets in particular fixed assets representing a significant element of their asset profile. In accordance with Financial Reporting Standard 11 (Impairment of Fixed Assets and Goodwill)<sup>5</sup> (“FRS 11”) credit unions should carry out a review for impairment of fixed assets if events or changes in circumstances indicate that the carrying amount of the fixed asset may not be recoverable.

Where circumstances indicate that there is an impairment review required and a “value in use” approach is adopted, the directors should consider the appropriateness of the underlying assumptions used in deriving the expected cash flows to ensure that they are reasonable and supportable.

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<sup>4</sup> These guidance notes are available at [www.centralbank.ie](http://www.centralbank.ie) in the Credit Union Handbook chapter on Investments.

<sup>5</sup> Financial Reporting Standard 11 (Impairment of Fixed Assets and Goodwill) – issued by the Financial Reporting Council.



For some credit unions value in use is creating an illusion of capital strength when underlying market values of property assets are far lower than the carrying values. The value in use calculation should be supported by realistic assumptions aligned with financial projections derived from achievable and realistic business objectives and business activity levels which are consistent with the credit unions strategic plan. Where a value in use approach has previously been adopted subsequent monitoring against projected cash flows should be carried out in accordance with FRS 11.

## **5. Fitness and Probity Regime for Credit Unions**

Credit unions with assets of greater than €10 million are reminded that fitness and probity requirements have been fully implemented and apply from 1 August 2014 for all Pre-approval Controlled Functions and Controlled Functions. From that date, such credit unions must carry out due diligence before appointing an individual to a Controlled Function position in their credit union and ensure the individual complies with the Fitness and Probity Standards for Credit Unions and has agreed to continue to comply with the Standards. Further details were set out in “*Update on Fitness and Probity for Credit Unions*” (July 2014).

Credit unions are also reminded that all proposed appointments to Pre-approval Controlled Functions (“PCFs”), require the written approval of the Central Bank in accordance with Section 23 of the Central Bank Reform Act 2010 prior to the appointment being made<sup>6</sup>. Where a person wishes to seek election to the role of chair, the person and the credit union, need to allow sufficient time in advance of the annual general meeting for the PCF applicant, the credit union and the Central Bank to process the person(s) application for the PCF role.

Full details of the Fitness and Probity regime for credit unions are contained in the Fitness and Probity – Credit Unions section of the Central Bank website.

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<sup>6</sup> See section 6.2.4 of the Guidance on Fitness and Probity for Credit Unions for further details on the requirements when PCFs are re-elected/re-appointed.



## 6. Annual Audited Accounts

Credit unions are reminded that Section 114(4) (c) of the 1997 Act requires that a credit union shall not publish, for any financial year, any income and expenditure account, balance sheet or statement unless it has been signed:

- *by the manager of the credit union;*
- *by a member of the board oversight committee acting on behalf of that committee; and*
- *by a member of the board of directors acting on behalf of the board.*

## 7. Legislative Changes and the Annual General Meeting Process

Credit unions are reminded that there have been significant legislative changes during 2013 and 2014 with the commencement of new legislation including:

- Credit Union and Co-operation with Overseas Regulators Act 2012
- Central Bank (Supervision and Enforcement) Act 2013
- Personal Insolvency Act 2012

With effect from 3 March 2014 all credit unions are required to have a board of directors with 7, 9, or 11 members in accordance with Section 53(3) of the 1997 Act.

Section 53(6)(b) of the 1997 Act requires that the full board is to be re-elected by secret ballot at the annual general meeting or special general meeting first occurring after 3 March 2014. Furthermore, the number of directors whose term of office expires at each general meeting shall, as near as possible be the same. To comply with this section of the 1997 Act credit unions, should appoint similar numbers of directors for 1, 2 and 3 year terms.

With effect from 3 March 2014 the board oversight committee is required to report to the members at the annual general meeting or special general meeting on whether the board has acted in accordance with Part IV and Part IVA of the 1997 Act.



Credit unions must submit their 30 September 2014 draft audited financial statements information via the ‘Draft Financial Statements’ on the Online Reporting system, prior to setting a date for the 2014 annual general meeting. Once this submission has been completed, the credit union may proceed with setting a date for the 2014 annual general meeting. However, those credit unions that are required to make a submission in relation to the Regulatory Reserve Ratio or have otherwise been notified shall not set a date for the 2014 annual general meeting until agreement has been reached with this office.

#### **8. Change in Auditor**

Credit unions are reminded of their obligations to notify this office in accordance with the provisions of Section 117 of the 1997 Act regarding a change in the auditor.

#### **9. The Submission of the Year End Return**

The Year End Return (consisting of Draft Financial Statements, Final Financial Statements, Annual Audited Accounts, AGM Notification and Annual Return) will only be accepted via the Online Reporting System (ONR). A notice in relation to the Year-End Return is being sent to all credit unions and is enclosed with this letter<sup>7</sup>.

Further details on the year-end process were contained in the “*Credit Union News*” (July 2014).

If the credit union intends to change the 2014 End Return Contact or Year End Verifier, on the Online Reporting system, sufficient time must be allowed to set up the new user account. Please email [regulatorytransactions@centralbank.ie](mailto:regulatorytransactions@centralbank.ie) should you wish to request a new ONR user account.

#### **10. Annual Compliance Statement**

Since 3 March 2014, all credit unions are required to submit an annual compliance statement to the Central Bank within two months of the end of the financial year of the credit union, i.e by 30

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<sup>7</sup> The Notice imposing the requirements to submit the Year-End Return arises from the Central Bank’s new information gathering powers introduced following the commencement of the Central Bank (Supervision and Enforcement) Act 2013





November each year. Guidance on the annual compliance statement is set out in section 2.4 of the Governance Chapter of the Credit Union Handbook.

Credit unions should submit the annual compliance statement electronically to the Central Bank using the Online Reporting System. Further guidance, including a user manual, on submitting the annual compliance statement will be made available to credit unions in September 2014.

### **11. Planning by Credit Unions for the Implementation of the new Financial Reporting Standard 102**

In March 2013, the Financial Reporting Council published Financial Reporting Standard 102 (the “Standard”) which is moving local Generally Accepted Accounting Principles (GAAP) to the International Financial Reporting Standards (IFRS) framework.

This new Standard replaces virtually all existing local accounting standards and will be the accounting standard under which credit unions will be required to prepare their annual audited accounts. Adoption of this Standard is mandatory for year-ends beginning on or after 1 January 2015. Effectively all credit union accounts for year-end 30 September 2016 will be required to be prepared under this Standard with restatement of 2015 comparatives also required at that time (i.e. for accounting periods commencing 1 October 2014).

The adoption of this Standard by credit unions will give rise to many changes in the requirements applicable to key areas of accounts preparation and financial reporting. While mandatory adoption is not required until September 2016 year ends, credit unions should now begin to consider and plan for the implementation of the new requirements. In particular credit unions should begin to engage with their auditors and IT suppliers to ensure that they identify the necessary steps and actions required so that they are adequately prepared for transition to this Standard in accordance with the relevant timelines.



The Registry of Credit Unions intends to engage with the sector stakeholders including the accountancy bodies on this matter and will provide further updates to credit unions on regulatory aspects arising. The Standard can be accessed on the Financial Reporting Council website<sup>8</sup>.

**Credit unions should prepare well in advance to ensure that the 2014 year-end process operates as smoothly as possible. Where credit unions require further clarification on the process they should contact the supervisor dealing with their credit union as early as possible.**

A copy of this circular will also be sent to the auditors of all credit unions.

Yours faithfully

A handwritten signature in blue ink that reads "Anne Marie McKiernan".

**Anne Marie McKiernan**  
**Registrar of Credit Unions**

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<sup>8</sup> [frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/Standards-in-Issue/FRS-102-The-Financial-Reporting-Standard-applicabl.aspx](http://frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/Standards-in-Issue/FRS-102-The-Financial-Reporting-Standard-applicabl.aspx)

## **Appendix 1**

### **Summary of the Changes to the Regulatory Framework in 2014**

#### **3 March 2014**

A number of provisions of the Credit Union and Co-operation with Overseas Regulators Act 2012 have been commenced. The main amendments to the 1997 Act arising from the commencement of these provisions are:

- A new section 53 which relates to the board of directors was substituted
- Section 66C which is the requirement for the submission of an annual compliance statement to the Central Bank
- Section 76O(7) which relates to the board oversight committee report to the members at the AGM

The *“Implementation of the New Governance and Prudential Requirements for Credit Unions – Frequently Asked Questions – July 2014”* available on the Central Bank website contains information on the introduction of these new requirements.

#### **1 August 2014**

Fitness and Probity regime was fully implemented for credit unions with total assets greater than €10 million and applies to all Pre-approval Controlled Functions and Controlled Functions.

Further details on the Fitness and Probity regime are available on the Fitness and Probity – Credit Unions section of the Central Bank website.

**Appendix 2 Information for credit unions required to make a submission in relation to the payment of a proposed dividend.**

***Accounts:***

1. Draft financial statements for the year ending 30 September 2014.

***Proposed Dividend:***

2. The percentage and amount of dividend proposed.

***Bad and Doubtful Debt Provisions:***

3. Details of bad and doubtful debt provisions contained in the draft financial statements including the following:
  - The summary Resolution 49 report or equivalent and the amount held as general provision at 30 September 2014.

***Liquidity:***

4. Details of the liquidity position including the following:
  - A list of all deposits and investments (including cash and current accounts) with maturity dates on or before 31 December 2014.
  - A list of all deposits and investments (including cash and current accounts) with maturity dates between 1 January and 31 March 2015.
  - Unattached shares at 30 September 2014 and projected unattached shares at 31 December 2014.