Central Bank of Ireland - RESTRICTED

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Credit Union Auditor

By email

30 August 2017

Re: 2017 Financial Year end

Dear Auditor

As the 2017 financial year end for credit unions is approaching it is timely to remind auditors of credit unions of their statutory reporting obligations to the Central Bank of Ireland ('the Bank'), to set out our observations on the 2016 financial year end, incorporating the first time adoption of FRS 102, and our expectations for the 2017 financial year end.

Statutory Reporting

Section 122 of the Credit Union Act 1997 (the Act) requires credit union auditors to make a report to the Bank if at any time the auditor of the credit union;

(a) Has reason to believe that there exist circumstances which are likely to affect materially the credit union's ability to fulfil its obligations to its members or meet any of its obligations under the Act;
(b) Has reason to believe that there are material defects in the accounting records, systems of control of the business and records of the credit union;
(c) Has reason to believe that there are material inaccuracies in or omissions from any returns made by the credit union to the Bank;
(d) Proposes to qualify any report which he is to provide under this Act;
(e) Has reason to believe that there are material defects in the system for ensuring the safe custody of all documents of title, deeds and accounting records of the credit union; or
(f) Considers that the board of directors have failed to respond to any recommendations made by him.

The Bank expects full compliance with these statutory reporting obligations.

The above is consistent with Practice Note 27(1) (Revised) issued by the Financial Reporting Council in May 2016 ('the Practice Note'[1]) relating to the audit of credit unions in the Republic of

[1] https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Practice-Note-27(I)-(Revised)-The-audit-of-credit.pdf

Ireland. This states *inter alia* that the objective of the auditor of a regulated entity is to bring information of which the auditor has become aware in the ordinary course of performing work undertaken to fulfil the auditor's audit responsibilities to the attention of the appropriate regulator as soon as practicable when;

- The auditor concludes that it is relevant to the regulator's functions having regard to such matters as may be specified in statute or in any related regulations; and
- In the auditor's opinion there is reasonable cause to believe it is or may be of material significance to the regulator.

Statutory Duty Confirmations and Management Letters

Section 27B of the Central Bank Act 1997 requires credit union auditors to make a written report, the Statutory Duty Conformation ('SDC'), to the Bank within one month of the auditor's report on the credit union's financial statements. The SDC is a statement to the Bank that there is no matter, not already reported to the Bank in writing, that has come to the attention of the auditor during the ordinary course of the audit, that gives rise to a duty to report to the Bank. Where matters have already been reported to the Bank, such matters should be referred to in the SDC.

Pursuant to Section 22 of the Bank (Supervision and Enforcement) Act 2013 credit unions are required to provide to the Bank a copy of any report ('the Management Letter') which they have provided to a credit union on matters that have come to their attention during the course of the audit. This should be provided within 2 months of the date of the auditor's report on the credit union's financial statements. The auditor is also required to provide a copy to the Bank of any response received from the credit union to the Management Letter within one month of having received such response.

The Practice Note states in relation to management letters *inter alia* that the objective of the auditor is to communicate appropriately to those charged with governance and management, deficiencies in internal control that the auditor has identified during the audit and that, in the auditors professional judgement, are of sufficient importance to merit respective attentions.

The Bank has noted that the content and quality of the management letters received by it is variable in highlighting areas that auditors have identified, particularly in relation to deficiencies in systems, controls and related governance. This finding has been reinforced by matters coming to Bank supervisors attention through on site PRISM visits. The Bank would urge auditors to ensure that all internal control matters they judge to be materially significant in the course of their audit are brought to the credit unions attention through the management letter and which, in turn, are communicated to the Bank.

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Observations on 2016 Year End

2016 was the first year of adoption of FRS 102 by credit unions in their annual audited accounts. FRS 102 brought about significant changes to the content and format of these accounts, including but not limited to, the following areas;

- Loan interest income to be calculated on the carrying amount of the loan book using the Effective Interest Rate method.
- Loan provisions to be based on objective evidence of impairment, through either individual loan provision assessments for significant loans or collective assessments for less significant loans that have similar characteristics. General provisions are no longer permitted under the standard.
- Investments to distinguish between basic financial instruments, which are to be valued at amortised cost using the Effective Interest Rate method, and complex financial instruments, which are normally valued at Fair Value.
- A number of new disclosure notes were introduced, including new disclosures on credit risk and key management personnel compensation. The notes to the annual accounts are also to include an explicit and unreserved statement to the effect that the financial statements comply with FRS 102. Financial Statements are not to be described as complying with FRS 102 unless they comply with all the requirements of the FRS.

However the following observations were characteristic of a significant number of credit union draft annual accounts reviewed;

- Loan interest income continuing to be calculated on a cash receipts basis.
- Continued reliance on traditional methods of calculating loan provisions, lack of adequately documented provisioning methodology, and lack of documented estimation techniques to support objective evidence of impairment.
- Misclassification of investments between Basic and Complex products.
- Failure to reconcile the Cash Flow Statement to cash and cash equivalents, as required by FRS 102.
- Disclosure notes frequently in template format, or incomplete or omitted, including in some instances, the note on explicit and unreserved compliance with FRS 102.

These findings led to the conclusion that, overall, many credit unions were insufficiently prepared for the introduction of FRS 102, and did not fully understand the implications of the new standard on the annual accounts preparation, including understanding the separate and distinct roles of boards of directors to prepare the financial statements in accordance with applicable law and accounting standards, and for the credit union auditor to audit the financial statements prepared by the directors and express an opinion on the financial statements.

Auditor Roundtable

On 26 July 2017, as part of the Banks ongoing and pro-active engagement with external stakeholders, a roundtable discussion was held with a number of credit union external auditors and representatives from the Institute of Chartered Accountants in Ireland (ICAI) and the ACCA[2]. The Bank outlined its ongoing concerns in relation to the governance and systems and controls in credit unions and emphasised the importance of stakeholder understanding of the respective roles of auditors, credit unions and the Bank as regulator. The Bank also stressed the importance of auditors complying with their statutory reporting obligations and the need for auditors to remain vigilant to any issues which may indicate deficiencies in internal controls and any risks of material misstatement in credit union financial statements and/or books and records. The Bank indicated that a review of the outcome for 2017 credit union year- ends would be undertaken and that, aligned with the outcomes of our supervisory engagement with credit unions, will determine the need for any further engagements which may be required with the auditing profession.

Expectations for 2017 Year Ends

Auditors should prepare early for their 2017 credit union audits, including engagement with their respective credit union clients. This is in order to assess the state of preparation for the annual accounts, with particular reference to FRS 102 requirements and bearing in mind the undertaking in the notes to the accounts that the annual accounts are in compliance with the standard. Appropriate consideration should also be given to any issues arising that may require a reporting obligation to the Bank under Section 122 of the Act.

Finally, auditors are reminded of the guidance available on the audit of credit unions in the Practice Note.

Yours faithfully

Elaine Byrne

Elaine Byrne

Deputy Registrar of Credit Unions

[2] https://www.centralbank.ie/news/article/statement---roundtable-with-credit-union-external-auditors