



Emerging Audit Trends

ACUIA Region 2 Annual Virtual Meeting

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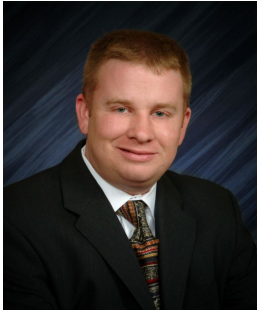
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Today's Presenters



Stephen J.M. Schiltz, CPA
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Steve Schiltz is a principal with CLA's Tucson office. He began his career with CLA in 2002 and has extensive experience providing assurance and consulting services to credit unions. Steve has made presentations to management teams, supervisory committees, and boards of directors, as well as national speaking engagements and webinars.

A licensed CPA in Arizona and Texas, Steve is a member of the AICPA, Arizona Society of CPA's and the Beta Gamma Sigma Honor Society. He received his bachelor's in accounting, cum laude, from the University of Arizona in Tucson.



Today's Presenter



Bryan W. Mogensen, CPA

Principal

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Bryan has worked on audit and consulting engagements throughout his 27 years of public accounting experience in and has devoted the last 30 years specifically to credit union industry clientele. Bryan serves as the leader of the CLA's Western region credit union and credit union employee benefit plan audit practices. His background includes overseeing and managing audits of credit unions, credit union service organizations, profit sharing plans, 401(k) plans, defined benefit plans, employee and group health plans.

Bryan holds a Bachelor's in accounting from the University of Wisconsin – Milwaukee. He is a member of the AICPA National Credit Union Conference Steering Committee and the Arizona Certified Public Accountants Society.



Agenda

Discuss recent issues auditors should consider

Grants to
credit unions

Impact of
deposit
growth

Call Report
Modernization
(CRM) project

Leases

CECL

Split dollar life
insurance
plans

Limited
staffing



Review impact of items on internal audit plan





Grants to Credit Unions

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Polling Question 1

Has your credit union received grant awards?

A. Yes

B. No

C. Unsure



Grants to Credit Unions

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



Grants to Credit Unions

- Great way to assist the communities credit unions serve, however:
 - Each grant agreement has requirements for receiving and reporting fund usage
 - If federal grant expenditures are more than \$750,000 in a year it triggers additional audit requirements
 - Grant funds are considered to be expended when used for their designated purpose (not when received from Treasury)



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





Impact of Deposit Growth



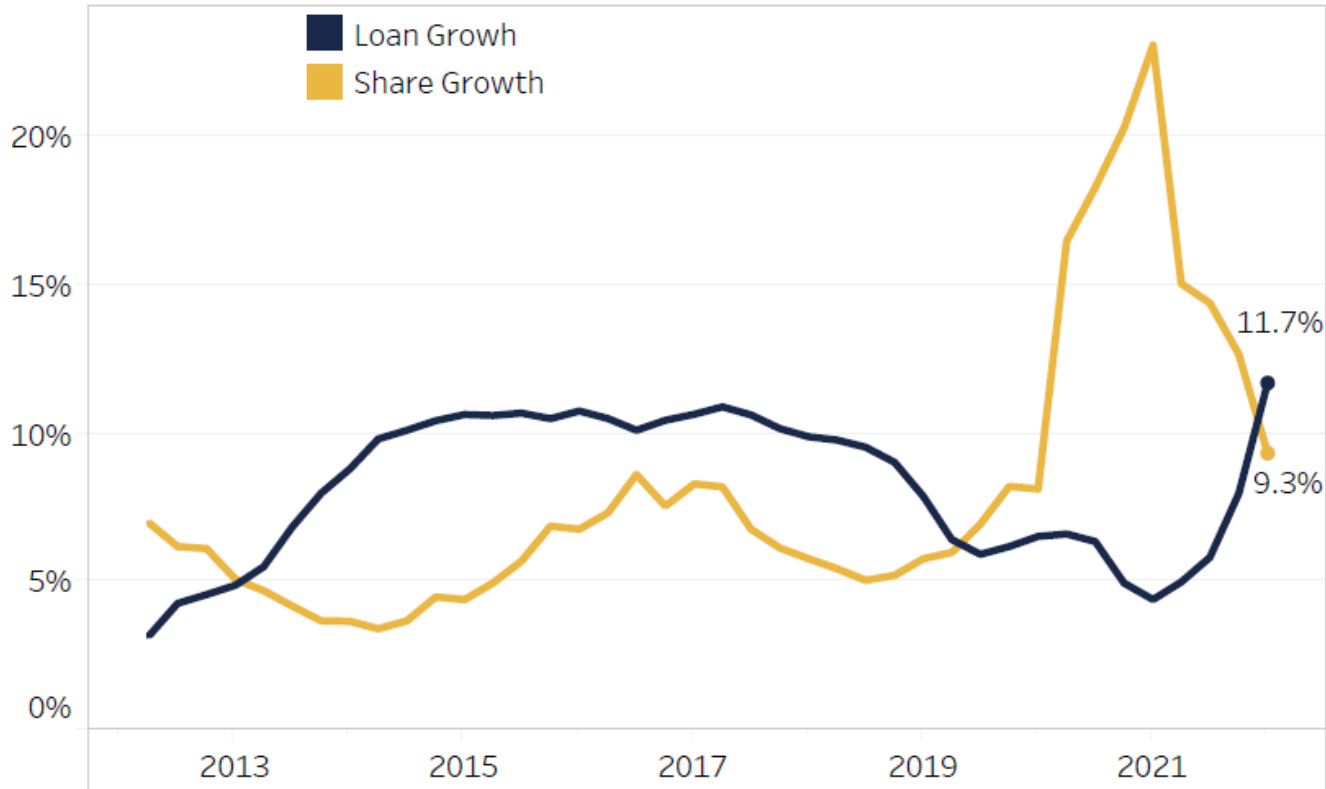
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Impact of Deposit Growth

Loan Growth vs. Share Growth (YoY)

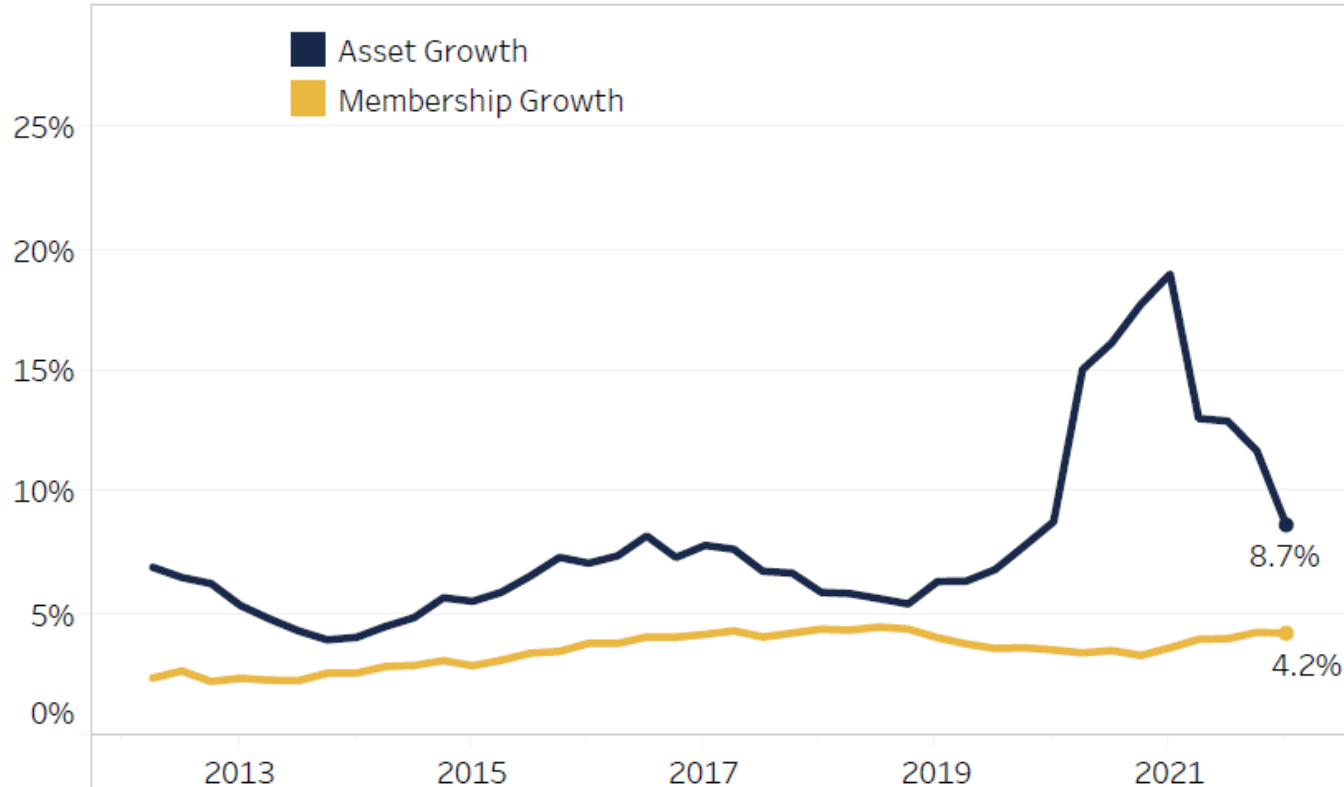


Source: NCUA
Financial
Trends in
Federally
Insured Credit
Unions



Impact of Deposit Growth

Asset Growth vs. Membership Growth (YoY)

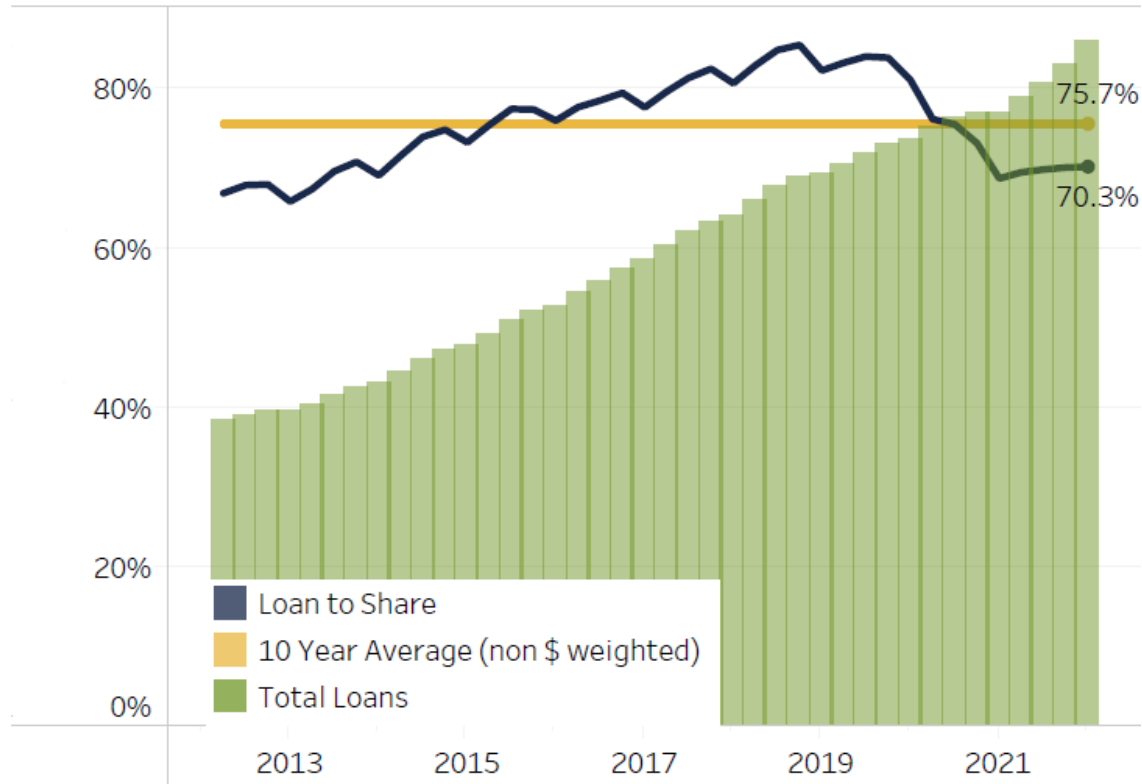


Source: NCUA
Financial
Trends in
Federally
Insured Credit
Unions



Impact of Deposit Growth

Total Loans / Total Shares



Source: NCUA
Financial
Trends in
Federally
Insured Credit
Unions



Impact of Deposit Growth

Investment Growth by Maturity

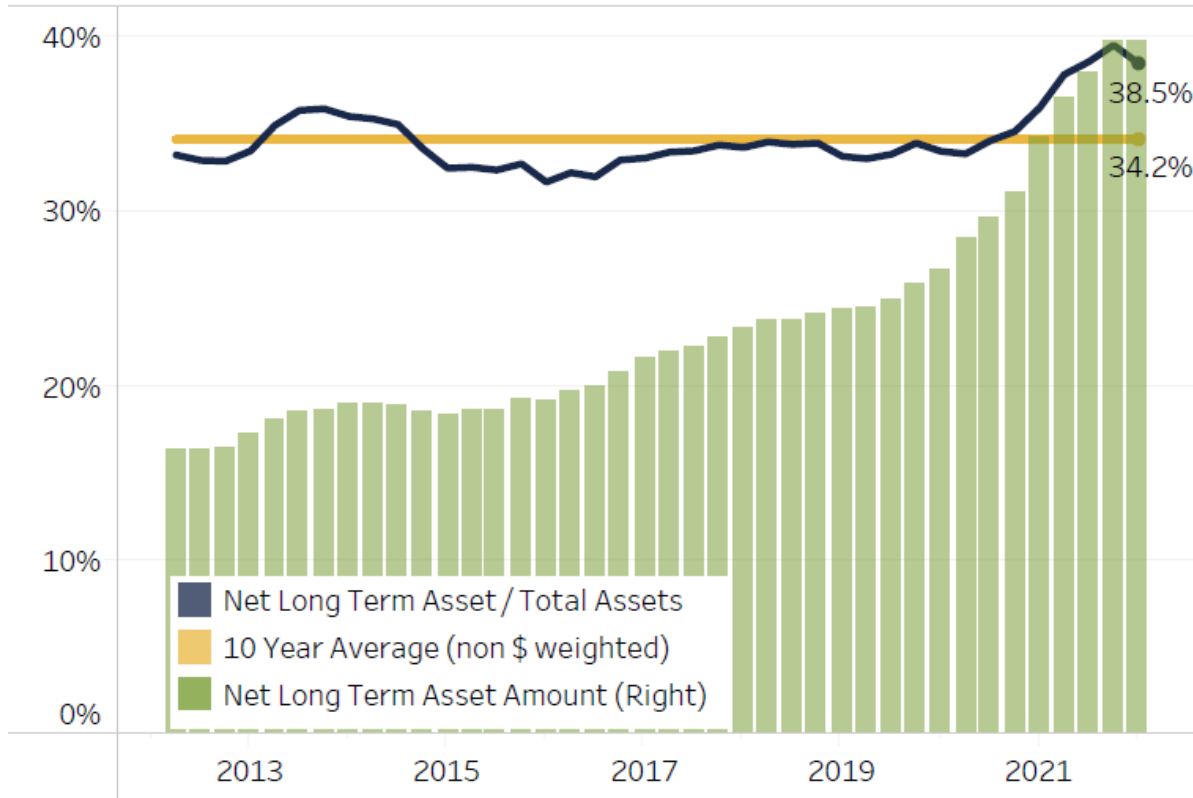
	<1 year	1 - 3 years	3 - 5 years	5 - 10 years	>10 years
2012 Q4	9.1%	0.9%	18.6%	27.6%	8.1%
2013 Q4	-10.4%	-16.6%	22.9%	60.2%	11.4%
2014 Q4	-3.9%	11.6%	-4.7%	-30.1%	-21.5%
2015 Q4	1.4%	2.2%	-5.8%	0.3%	-20.7%
2016 Q4	10.1%	-6.7%	-9.9%	10.5%	-12.3%
2017 Q4	-3.7%	-8.9%	4.9%	3.5%	3.4%
2018 Q4	-1.0%	-0.2%	-11.9%	0.1%	-3.5%
2019 Q4	11.6%	6.6%	-7.6%	-1.9%	43.9%
2020 Q4	24.7%	23.6%	35.6%	72.9%	131.6%
2021 Q4	-8.1%	1.9%	71.5%	81.7%	40.8%
2022 Q1	-11.7%	10.2%	34.2%	36.6%	10.8%

Source: NCUA
Financial
Trends in
Federally
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Unions



Impact of Deposit Growth

Net Long Term Assets / Total Assets



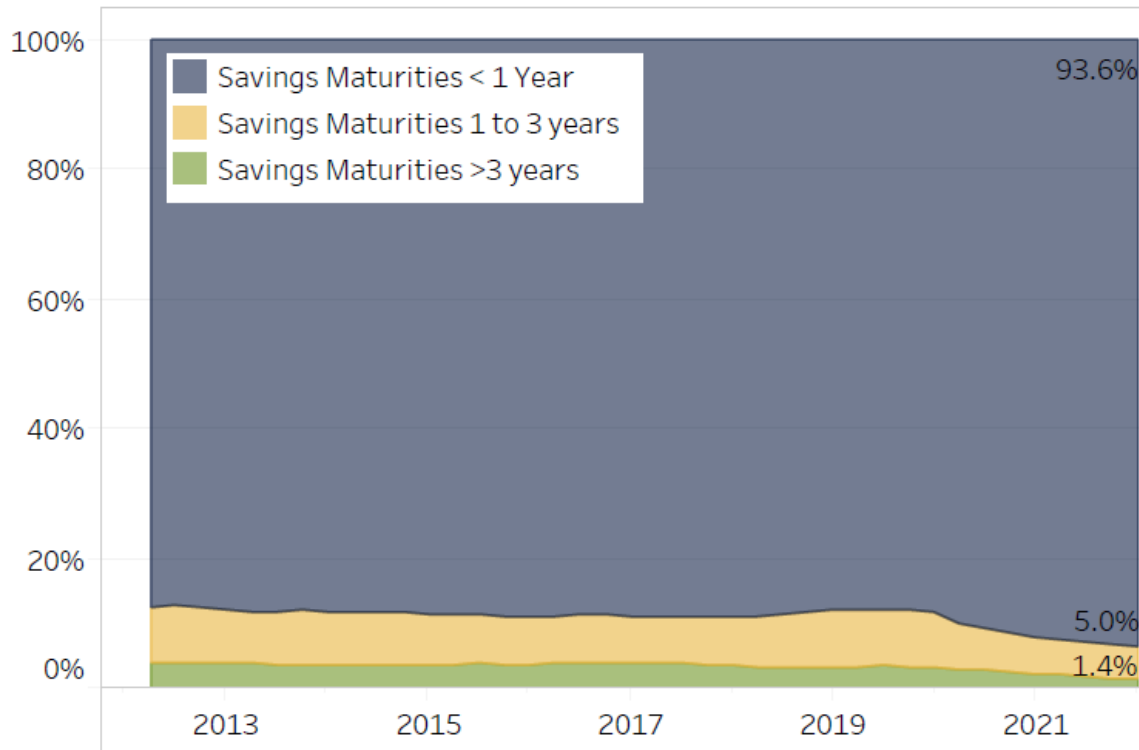
Source: NCUA
Financial
Trends in
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Unions



Impact of Deposit Growth

Savings Maturities

(% of Total Shares & Deposits)



Source: NCUA
Financial
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CRM Project

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Call Report Modernization (CRM) Project

- 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



Call Report Changes Effective 3/31/22

- The new call report contains 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. Supplemental Info (Grants, Employees, Branches, International Remittances, CUSOs, MSBs)

F. Derivatives

G. Prompt Corrective Action

H. CCULR Ratio

I. Risk Based Capital (5 pages)



CCULR Eligibility

- Net worth ratio of 9% or greater
- Off-balance sheet exposures of 25% or less of total assets
- Trading assets and trading liabilities of 5% or less of total assets
- Goodwill and other intangible assets of 2% or less of total assets



CRM Project Burden Reduction

Call Report: Total Fillable Account Codes

	December 2021 Call Report	March 2022 Call Report	% Change
Credit unions \leq \$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%

Source: NCUA 5300 Call Report Webinar on March 8, 2022





Leases

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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

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Polling Question 2

Where is your credit union at in adopting CECL?

- A. Who is CECL?
- B. We are just getting started
- C. We have a model selected and are running the calculation
- D. We early-adopted



Current Expected Credit Losses (CECL)

- 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



What is CECL?

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



Capital Relief

- Initial CECL adjustment is to undivided earnings
- Credit unions may elect to “phase-in” the impact of CECL over three years for regulatory capital purposes
- The Call Report will do this automatically
- The phase-in is not eligible for early-adopters
- GAAP accounting is unchanged

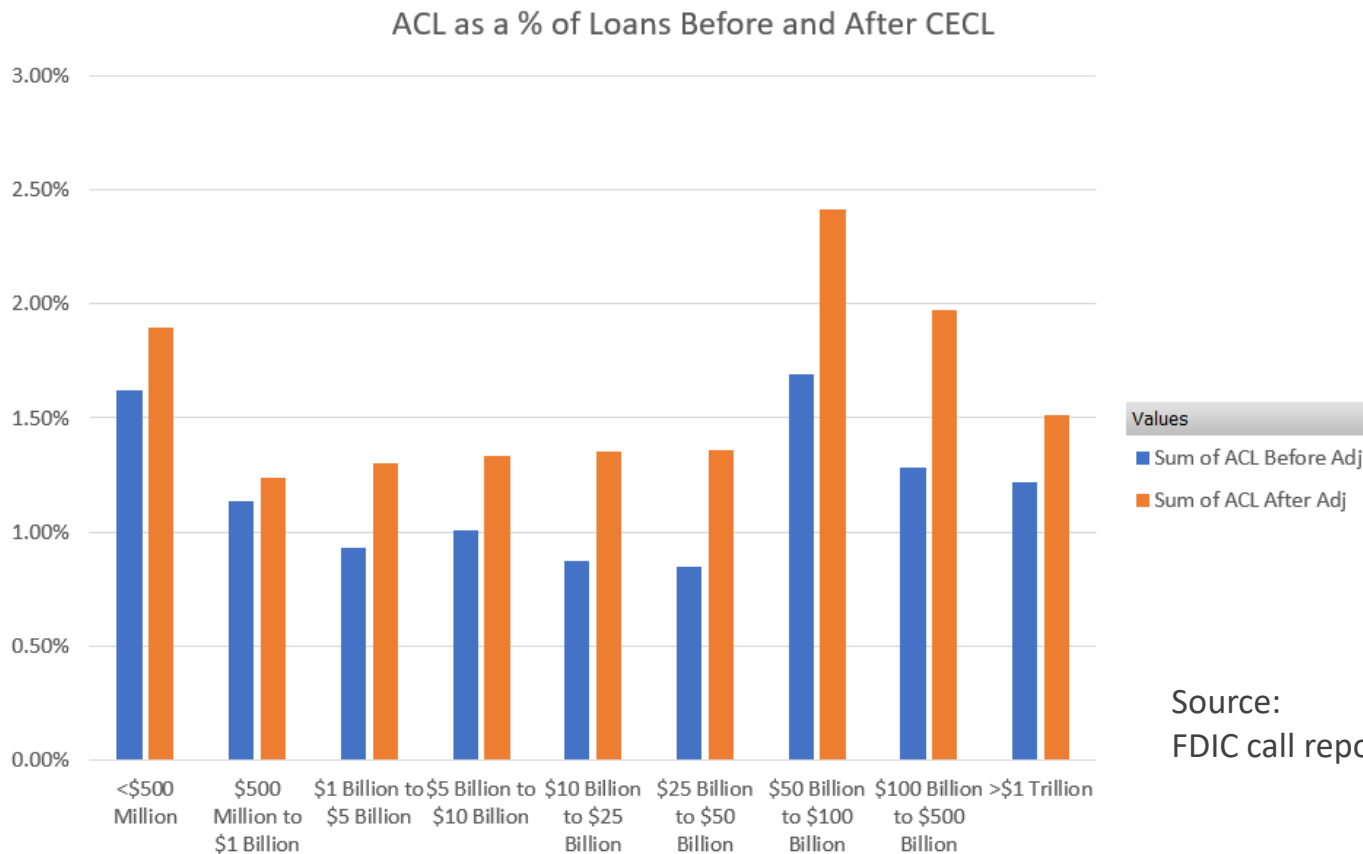


Effective Dates

- Some private and all public entities have adopted
- Credit unions must adopt for annual reporting periods beginning after December 15, 2022, including interim periods within those fiscal years.
 - For many credit unions, this is January 1, 2023
 - NCUA issued an Accounting Alert on July 20, 2022 indicating that you may follow your audited financial reporting year – a September 30 year-end would adopt on October 1, 2023



Impact of CECL by Asset Size

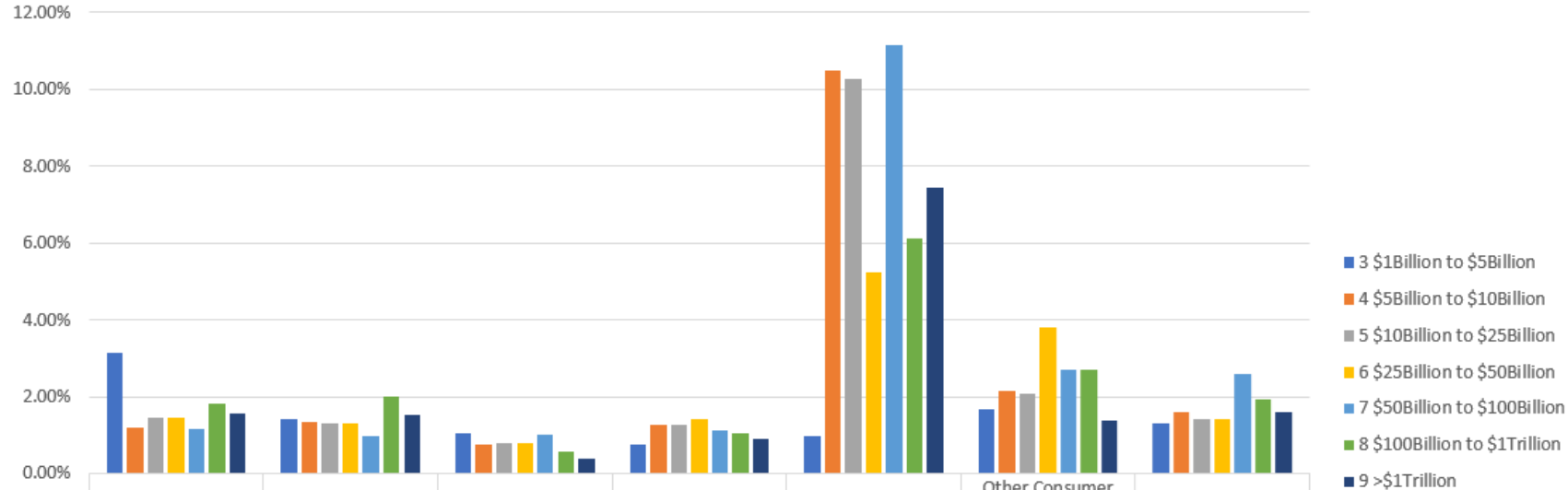


Source:
FDIC call report data



Impact of CECL by Loan Type

ACL By Category



	Construction ACL %	CRE ACL %	Residential ACL %	Commercial ACL %	Credit Cards ACL %	Other Consumer ACL %	ACL/Loan Balance
3 \$1Billion to \$5Billion	3.15%	1.43%	1.04%	0.77%	0.98%	1.68%	1.32%
4 \$5Billion to \$10Billion	1.18%	1.33%	0.74%	1.26%	10.47%	2.14%	1.62%
5 \$10Billion to \$25Billion	1.46%	1.30%	0.79%	1.27%	10.28%	2.07%	1.41%
6 \$25Billion to \$50Billion	1.46%	1.31%	0.79%	1.41%	5.22%	3.79%	1.43%
7 \$50Billion to \$100Billion	1.16%	0.96%	1.00%	1.13%	11.15%	2.71%	2.61%
8 \$100Billion to \$1Trillion	1.84%	2.00%	0.59%	1.07%	6.11%	2.70%	1.94%
9 >\$1Trillion	1.55%	1.54%	0.38%	0.89%	7.43%	1.36%	1.62%

Data Table

Source:
FDIC call report
data



Auditor Questions



Why did management select this model/methodology?



Are you using a third-party vendor and if so, did you obtain SOC-1 and Model Validation reports from them?



How did management determine the relevant data and assumptions are appropriate?



What system or model limitations were identified and how did management address these issues?



What is management's ongoing process for evaluation of data and models?



Auditor Questions



Are inputs and outputs from the model complete and accurate?



Does management have support for the key assumptions?



Did management contract for a CECL model validation ?



Are financial statement disclosures appropriate?



Is the allowance sufficient?





Split Dollar Life Insurance Plans

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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
- Accounting can be complex based on the details of the plan
- Recourse vs. non-recourse provisions



Split Dollar Life Insurance Plans

- 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 plus any interest receivable
- 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 plus any interest receivable



Split Dollar Life Insurance Plans

- Examiner and auditor concerns regarding under-collateralized plans
- Expanded call report disclosures to include more than just the recorded value:
 - Remaining premiums (commitment)
 - Cash surrender value (collateral)





Limited Staffing

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Polling Question 3

Considering recent growth, 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 Limited Staffing

The following trends have occurred over the last few 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?

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