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The Role of an Internal Audit in Credit Union Financial Decision Making

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THE ROLE OF AN INTERNAL AUDIT
IN CREDIT UNION FINANCIAL
DECISION MAKING

by

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This independent study submitted by John M. Howland in partial fulfillment of the requirements for the Degree of Master of Business Administration from the University of North Dakota is hereby approved by the Faculty Advisor under whom the work has been done.

Advisor

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ABSTRACT

The purpose of this paper is to show how an internal audit can be used in credit union financial decision making.

The paper analyzes in depth the kinds of data obtainable from an internal audit and the kinds of data required for credit union financial decision making. By utilizing a comparative analysis of the compatability of the two types of data, the paper shows how the data obtainable from an internal audit can be applied to credit union financial decision making.

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CHAPTER I

INTRODUCTION

A credit union is a group of people who save their money together and make loans to each other for good purposes at low interest. Each credit union is an independent, nonprofit corporation, chartered and supervised by the government.[1] The credit union is owned and operated by its members. The members set the general policies the credit union will follow. These policies must fall within the general constraints delineated by federal law.

A credit union is organized and operated similarly to many incorporated financial organizations. The members of the credit union are the shareholders. One share is equivalent to five dollars. The number of shares held by a member does not influence his control of the credit union. Each member is allowed one vote in all credit union decisions requiring a vote of the general membership. The membership elects a board of directors, which number between five and fifteen members, as long as it is an odd number. The board of directors is responsible for hiring the general management of the credit union. The board of directors is also responsible for appointing a supervisory committee.[2] The purpose of the supervisory committee is to represent its members. It serves as the credit union's internal auditor. The committee has the

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[1]Credit Union National Association, Credit Union Yearbook, 1962, Credit Union National Association, Madison, Wis., p. 26.

[2]Ibid.

responsibility to review and evaluate the performance of elected officials and employees and to make recommendations for improvement. As the internal auditor, the supervisory committee must conduct audits and related procedures designed to determine that: (1) accounting records and reports are prepared promptly and accurately reflect operations and their results; (2) established internal controls are effectively maintained and adequately protect the credit union, its members, its management, and its employees; and (3) each unit of the credit union is carrying out the plans, policies and procedures for which it is responsible.[3] The supervisory committee fulfills these responsibilities through the use of internal audits. These internal audits are performed randomly thoughout a fiscal year. There is no limit to the number of internal audits that may be performed. Federal law governing credit unions specify that, at a minimum, at least two internal audits must be performed per fiscal year.

These internal audits must be conducted using the instructions presented by the "Supervisory Committee Manual For Federal Credit Unions," which is published by the National Credit Union Administration. These instructions specify the exact manner in which all credit union internal audits should be carried out. The National Credit Union Administration furnishes each credit union supervisory committee with standardized working papers for use in recording data and analyzing it during the audit. Additional data is recorded for reference in addition to that required on the working papers. The supervisory committee is required to store all data from internal audits for future reference.

A credit union is faced with making certain financial decisions. These decisions must ultimately be made by the board of directors in

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[3]National Credit Union Administration, Supervisory Committee Manual For Federal Credit Unions, National Credit Union Administration, Washington, D.C., p. 3.

conjunction with the credit union management. The four financial decision areas requiring board of director approval are concerned with establishing interest rates, establishing dividend rates, determining proper liquidity levels, and determining the feasibility of various investments.[4] These financial decisions all require certain data in order that they may be adequately resolved. Much of this data is information internal to the credit union. It can be found in the records of the credit union.

This paper will identify in chapter II the kinds of information needed for these various credit union financial decision areas. It will also identify in chapter III the kinds of data available from an internal audit. Chapter IV will be devoted to making a compatability analysis, showing how the data needed for credit union financial decision making can be supplied from the internal audit. Chapter V will present the conclusions of this study.

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[4] National Credit Union Administration, Federal Credit Union Bylaws, National Credit Union Administration, Washington, D.C., 1970, p.4.

CHAPTER II

CREDIT UNION FINANCIAL DECISION MAKING

Financial decision making in credit unions can be classified into four basic categories. These categories all represent different financial decisions the credit union's management will encounter.

The first category involves dividend decision making. Dividend decision making is basically a question of "how much." A decision must be made to determine what rate of return members will receive on their shares.

The second category involves the fixation of interest rates on new loans. The credit union must determine a rate of interest to charge members who withdraw funds in the form of loans.

The third category involves investment decisions. The credit union must decide how excess funds are to be allocated in order to earn the highest rate of return on them.

The fourth category involves the determination of liquidity requirements. The credit union must determine what degree of liquidity it is compelled to maintain.

In order to make optimal financial decisions in these four categories, the credit union's board of directors must have certain information available. A discussion of the required information for credit union financial decision making in the four categories will follow.

Dividend Decision Making

Credit union dividend decisions are very similar to corporation dividend decisions. The information required is basically identical.

The credit union's board of directors must know the importance of dividends in regard to the stability of shareholders.[5] Shareholders are the foundation upon which a credit union is built. The most important asset that a credit union has is its goodwill among members. If a credit union loses its goodwill and support from members, it will cease to operate. Shareholders will withdraw their funds and the credit union will become insolvent. Most goodwill between the credit union and the shareholder is derived through the payment of dividends. The size and consistency of dividends is directly proportional to the amount of goodwill that exists between the credit union and its shareholders. The credit union's board of directors must be able to derive some degree of feel for the relative importance of dividends in relation to shareholder goodwill.

The dividend decision is notably dependent upon the liquidity requirements of the credit union.[6] A credit union must remain liquid to a certain degree in order to meet expected and unexpected cash drains. The credit union must know the present liquidity level and future liquidity level requirements. The credit union must ensure that any dividends paid do not infringe upon the minimum liquidity level the credit union deems necessary. Information indicating the present liquidity level, present liquidity level requirements, and future liquidity level requirements will be necessary to prevent this from occurring.

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[5]James C. Van Horne, Financial Management and Policy, 2nd Ed., Englewood Cliffs, New Jersey, Prentice-Hall Inc., 1971, p. 284.

[6]*Ibid.*

The credit union's ability to borrow needed funds will have a bearing upon the dividend decision.[7] A credit union that is well established will have little difficulty borrowing needed funds in a period of short cash. A newly established credit union with a shaky financial position will find funds available for borrowing rather scarce. A credit union that is unable to borrow funds in time of need will be forced to withhold earnings in a greater proportion than a credit union that has outside funds easily obtainable. The credit union must be able to analyze its borrowing capability and determine if needed funds may be borrowed during a period of short cash. This will provide the credit union management with a guideline on what percentage of earnings must be withheld from dividends to cover cash shortages.

The timing of investment opportunities must be considered before paying dividends.[8] The credit union must determine if there are investments available now, which will not be available later, that are more important to the credit union than paying a higher dividend. A credit union in need of a larger office building in the near future may elect to buy a building now at a low price instead of waiting until a larger building is a necessity and being forced into paying a higher price. Certain desirable security issues may be cheaper now than in the future. The credit union must first determine when investment opportunities are available and then determine their importance in relation to paying dividends.

The impact of inflation on the replacement of assets must be considered before paying dividends.[9] A credit union that sets aside funds

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[7] Ibid.

[8] Ibid.

[9] Ibid.

for the replacement of assets on the basis of depreciation on presently owned assets must consider the replacement costs of those assets. If inflation has caused a rise in the price of the asset, enough funds will not have been generated to replace them. Additional funds will be required that may have to come from retained earnings available for dividends. The credit union must know how much has been, or will be, set aside for the replacement of assets in comparison to the price of those assets.

In making a dividend decision, a credit union has only one legal restriction placed upon it.[10] A credit union cannot pay dividends in excess of six percent per year.

The final consideration in making a dividend decision is long term capital requirements.[11] The credit union must allocate funds on a periodic basis for long term capital requirements. The credit union must determine what the long run capital requirements of the credit union are, and that sufficient funds are being allocated for it, before paying out dividends.

Fixation of Interest Rates

Credit unions set interest rates on new loans using many of the same principles that banks and other financial institutions utilize.

The most important consideration in fixing interest rates is the rate at which potential borrowers can obtain funds at other institutions.[12] The credit union must be competitive. If borrowers can obtain lower rates

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[10] _Ibid._

[11] _Ibid._

[12] Jules I. Bogen, _Financial Handbook_, 4th Ed., New York, The Ronald Press Company, 1965, p. 5.

somewhere else, they will not patronize the credit union. The credit union must ensure that it is competitive with other financial institutions. Federal regulations require that a credit union not charge more than a twelve percent effective rate of interest per year.

The operating expenses of the credit union must be considered in relation to projected dividend requirements.[13] The credit union must have accurate data available on what it costs the credit union to operate. These expenses must come out of revenues before dividends can be paid. There must be some surplus remaining in order to maintain adequate reserves. The credit union must ensure that interest rates are high enough to generate adequate revenue in order to cover expenses, dividends, and surpluses.

The amount of deposited funds must be considered when establishing interest rates.[14] The credit union must make a policy decision on whether or not it will loan out more funds than are deposited. If it will not loan out more funds than are deposited, the credit union must be aware of loan balances at all times to ensure that they do not exceed deposit balances. If the policy of the credit union is to loan out more funds than are deposited, which is usually the case, it must borrow them from outside sources. A credit union normally has to pay a substantial amount of interest to these outside sources for the additional funds. The credit union must ensure that interest rates are high enough to cover the interest that must be paid on borrowed funds.

The credit union's demand for loans is a very important factor to consider when determining interest rates.[15] The credit union can

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[13]Ibid.

[14]Ibid.

[15]Ibid.

effectively change its loan demand by varying its interest rates. If a credit union's demand for loans is low, the demand can usually be raised by lowering the interest rate. When establishing the interest rate, the credit union must weigh what effect it will have on the demand for loans.

A final consideration in establishing the interest rate is the security of the loan.[16] If the loan is secured by collateral, a lower interest rate is usually deemed more feasible than on an unsecured loan. As a general rule; the higher the risk, the higher the interest rate should be.

Investment Decisions

Credit union financial decisions are similar to those made by almost any industrial or financial organization.

Before being able to make any investment decisions, the credit union must have knowledge of future cash flow requirements.[17] The credit union must know or have accurate forecasts of the amount of funds it will take in and the amount of funds it will dispense. Any investment the credit union is pondering should not infringe upon the cash flow in such a way as to cause a cash shortage. The credit union should have data illustrating both short term and long term cash flow requirements.

Future loan and deposit trends will play an important role in any investment decision.[18] The credit union should have some type of data illustrating funds that will be withdrawn in the form of loans and funds that will be deposited as shares. A credit union which has a large cash

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[16] Ibid.

[17] William H. Baughn, Charles E. Walker, The Bankers Handbook, Homewood, Illinois, Dow Jones-Irwin, Inc., 1966, p. 611.

[18] Ibid.

position now but expects a heavy loan drain in the near future may want to forego any immediate investments. Conversely, a credit union which has a large cash position now and expects it to increase in the future will probably want to put it to work in some type of investment.

In order to make investment decisions based on cash flow, loan demand, and deposit trends, a credit union must know what its liquidity requirements are.[19] The liquidity requirement will provide the credit union with a minimum figure from which to calculate cash flow, loan demand, and share deposits with. Any investment decision must not infringe upon the minimum required liquidity level.

Other data that the credit union must have is a comparison of the return from investments as opposed to the return of loans.[20] Many credit unions find the best investments are loans to members.

Determining Liquidity Requirements

Determining the proper liquidity level is very important to credit unions because the liquidity level requirement plays such an important role in other financial decisions.

Seasonal factors play an important role in determining liquidity level requirements.[21] A credit union whose members all vacation in the summer will find a unusually high withdrawal of funds during the summer months. Similarily, Christmas is another time of the year when many credit unions experience a large withdrawal of funds in the form of shares or loans. It is important for a credit union to know how these seasonal factors will effect liquidity levels.

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[19] *Ibid.*

[20] *Ibid.*

[21] *Ibid.*, p. 569.

The number of single large depositors will affect liquidity level requirements.[22] The possibility that one or two large depositors will withdraw all their funds at the same time must be provided for.

Population changes are an important factor to consider when determining an adequate liquidity level.[23] A competitor who offers higher interest rates than yours could cause an abundant withdrawal of funds.

The growth trend of the credit union is related to liquidity requirements.[24] Growth usually reduces the relative need for liquidity. The credit union should be able to predict its growth pattern in the future.

National economic conditions should not be overlooked when establishing a liquidity level.[25] Credit unions will feel the pressures of national economic conditions the same way as banks and other financial institutions.

Data concerning past deposit and loan activity on a trend basis will help predict future liquidity level requirements.[26] The plotting of these trends will help predict future deposits and loan requirements, thus providing valuable information in determining necessary liquidity levels.

Knowing the availability of quick cash is valuable when determining a required liquidity level.[27] Knowing that a large amount of funds

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[22] Ibid.

[23] Ibid, p. 570.

[24] Ibid, p. 571.

[25] Ibid.

[26] Ibid, p. 572.

[27] Ibid, p. 571.

can be borrowed in a hurry will allow a credit union to maintain a lower liquidity level. Conversely, the absence of a place to borrow quick cash will impel the credit union to maintain a higher liquidity level.

CHAPTER III

INFORMATION OBTAINABLE FROM A CREDIT UNION INTERNAL AUDIT

An internal audit of a credit union provides a wealth of information. This information can be classified into eleven categories. These categories are largely determined on the basis of the various operations performed during the audit. These categories are:[28]

1. overall operations
2. general, individual, and loan ledger balances
3. cash accounts
4. loans
5. regular reserve and undivided earnings
6. verification of member's accounts
7. investments and notes payable
8. operating expenses
9. furniture, fixtures, equipment, other assets, and other liabilities
10. surety bond and other insurance coverage
11. trends

Overall Operations

The overall operations phase of the internal audit provides four different kinds of data. These types of data cannot be assigned to any

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[28]National Credit Union Administration, Supervisory Committee Manual For Federal Credit Unions, National Credit Union Administration, Washington, D.C., 1972, p. 9.

specific audit task. The overall operation category is more of a catch-all category.

The first step of this phase is to examine the financial and statistical reports that are prepared monthly by the credit union. These reports are checked mainly to ensure accuracy with the data reflected in credit union records.

The second step is to ensure that the board of directors and the credit committee hold meetings at least monthly. These meetings are required by Federal Credit Union regulations and can be verified by checking the minutes from the meetings.

The third step is to review the minutes of the meetings, board of directors and credit committee, for accuracy. The minutes must convey what transpires at these meetings.

The fourth step is to examine the overall internal control of the credit union. This provides information relating mostly to the security of funds handled by the credit union. The information provided by this step of the audit is illustrated by Appendix 1. This worksheet provides little financial information. It is concerned mainly with internal control techniques.

General, Individual, Share, and Loan Ledger Balances

The general ledger balance is performed to ensure the general accuracy of the ledgers. It is performed by utilizing the form illustrated by Appendix 2. This step of the audit transcribes the data in the credit union ledgers, makes any necessary adjustments, and then illustrates an adjusted balance. The data in the adjusted balances depicts the most up to date information on all credit union accounts.

This part of the audit also accomplishes trial balances of individual loan and share ledgers. This is achieved by adding up all individual shares and loans, and then comparing them with their respective ledger balances. Appendix 3 is the worksheet used for this operation.

Cash Accounts

The internal audit examines the cash accounts by performing an actual cash count and then doing a bank reconcilement. Appendix 4 is the worksheet that is used for cash counts. One worksheet is used for each individual cash account maintained by the credit union. The total of these worksheets reveals the amount of cash maintained by the credit union.

The bank reconcilement is used along with the cash count to check the total of the cash account in the general ledger. The bank reconcilement is accomplished by getting official balances from the bank and comparing them to the balances in the credit union ledger. Appendix 5 is the worksheet used for this operation.

The total cash on hand may be calculated by adding the adjusted total of the bank reconcilement to the total of the individual cash accounts maintained within the credit union.

Loans

The internal audit examines three main facets of the loan accounts. The audit examines interest rates, loan failures, and loan exceptions.

Loan exceptions are of an administrative type nature. The auditor searches for mistakes in filling out the loan paperwork or loans that were issued without securing sufficient collateral. Appendix 6 is the worksheet used for recording these exceptions. The data supplied is the name of the borrower, the date of the loan, the unpaid balance of the loan, and any comments regarding the discrepancy.

An examination is made of charged off loans and recoveries. This is done to determine the size of the charged off loan account and to ensure that the charge off was approved by the board of directors. Appendix 7 is used for recording this information. The information gathered is the name of the borrower, the original loan, the charge off, the amount of recovery, the date the board voted the charge off, the type of collateral, whether or not the collateral was converted, and whether or not an attorney or collection agency was used.

The internal audit also performs an in depth analysis of interest rates. The auditor calculates the amount of interest that should have been received from each loan. He totals these figures and compares the total to the amount of interest collected as represented by the ledger. A difference of five percent is considered acceptable. While calculating the total interest collectible, an average interest rate for all loans outstanding is also computed. Identical calculations are also made for interest refunds. Appendix 8 is the worksheet that is used for these calculations and the presentation of the information.

Regular Reserve and Undivided Earnings

The internal audit requires an analysis of reserve and undivided earnings accounts. The recording and analysis of data is accomplished on Appendix 9. The information displayed on this worksheet includes beginning balances, ending balances, and all additions or deductions from these accounts. The present standing of these accounts, as of the time of the audit, can be easily ascertained by referencing the balances on this worksheet. The worksheet also breaks down additions or deductions into specifics including dollar amounts, sources, and percentages.

Verification of Member's Accounts

This procedure is accomplished by comparing member's account balances with credit union records. Statements are mailed to all members and they are asked to report any discrepancies. The results of this verification are recorded on Appendix 10. All accounts are listed by account number, member's name, date account opened or closed, and any action taken as a result of the verification.

Investments and Notes Payable

The internal audit examines all investments held by the credit union and all loans made to the credit union. This information is gathered and recorded through the use of a form represented by Appendix 11. This form reports date of loans or investments, amount loaned or borrowed, amount repaid, unpaid balances, terms of the note, interest rates, and interest paid or received, depending upon the situation. Any assets pledged as security are also recorded on the form.

Operating Expenses

All expenses are checked in detail during an internal audit. Completion of this audit step requires the auditor to review invoices, expense vouchers, cancelled checks, payroll records supporting expenses, expense ledger, journal and cash record, general journal, board of directors meeting minutes, and monthly financial and statistical reports.[29] If the investigation uncovers any questionable items, notes should be made for later clarification.

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[29]National Credit Union Administration, Supervisory Committee Manual For Federal Credit Unions, National Credit Union Administration, Washington, D.C., 1972, p. 53.

Furniture, Equipment, Fixtures, Other Assets and Liabilities

An estimation should be made for the value of each of these items. The ledgers should then be examined to determine if this value is reflected. Rates of depreciation should be adjusted to reflect the actual value of these assets. From this part of the audit, actual asset values and acceptable rates of depreciation should be determined.

Surety Bond and Other Insurance Coverage

The internal audit must investigate surety bond and insurance coverage. After determining the worth of the credit union from the audit, it must be assured that coverage is adequate. A listing of all policies, expiration dates, and information on payment of premiums should be prepared.[30]

Trends

All important credit union trends are computed during the audit. Appendix 12 is the worksheet on which these trends are recorded. The backside of this worksheet provides information on how these nineteen trends may be calculated. The nineteen may be easily determined by referencing Appendix 12.

Other Data

The internal audit provides many other types of data not mentioned here. Nearly all of this additional information is of an administrative nature and has no financial bearing importance. Appendix 13 represents the additional data available through a credit union internal audit.

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[30] Ibid, p. 69.

CHAPTER IV

THE ROLE OF AN INTERNAL AUDIT IN CREDIT UNION FINANCIAL DECISION MAKING

The determination of liquidity requirements plays an important role in the other three areas of credit union financial decision making. In making this comparative analysis of data required for credit union financial decision making and data obtainable from an internal audit, this paper will first discuss liquidity decisions followed by investment decisions, interest rate decisions, and dividend decisions, in that respective order.

Determining Liquidity Requirements

In review, there are eight essential items that must be known to properly determine liquidity requirements. These items can be briefly stated as follows:

1. seasonal requirements
2. number of single large depositors
3. population changes
4. competitive developments
5. growth pattern
6. national economic conditions
7. deposit and loan activity on a trend basis
8. availability of quick cash

The computation of important credit union trends during the audit provides a valuable insight into seasonal requirements. The trends are broken down into yearly quarters as shown by Appendix 12. The important seasonal requirements to know are the amount of loans outstanding, amount of shares, number of loans, average amount of loans, percentage of loans to shares, and the percentage of reserves to loans. These factors all give valuable information on the liquidity level requirements of the credit union. The internal audit provides all these factors on a quarterly basis. The information is useful on a quarterly basis, but would probably be much more useful if broken down into monthly periods. Unusual transactions during one month would be reflected as the whole quarter being unusual. Therefore, this quarterly information must be used with caution.

The number of single large depositors is not revealed by the internal audit. Although each individual account is checked for accuracy, no attempt is made to make a numerical counting of large depositors. The only calculation that is performed concerning this is the number of shares that the average member has.

Population changes and competitive developments are external to the credit union. The internal audit has no way of monitoring external factors.

The growth pattern of the credit union can be determined through the use of internal audits. The yearly growth trend is recorded on Appendix 12. Pertinent growth information such as total assets, total loans, and the number of members are presented on a quarterly basis. An internal audit can provide this information for a single year only. A growth pattern over a period of years can be easily obtained by referencing the results of previous audits in conjunction with the present audit. By doing this, a growth trend over a period of years can be projected. Caution must be exercised in projecting any credit union growth patterns. The membership size of a credit union is limited by the constraints placed upon it by its bylaws. Once the maximum membership within these constraints is reached, the credit union will not experience much additional noticeable growth. It becomes important, then, to apply growth information presented by the internal audit in relation to growth constraints when using the audit data for decision making.

National economic conditions are another external factor. There is no way an internal audit can monitor, analyze, or present data concerning these factors.

Past deposit and loan activity on a trend basis is determined by an internal audit. Appendix 12 presents all loan and deposit activity on a quarterly basis. As in determining the growth pattern of the credit union, the results of past internal audits must be referenced to have any useful trend information. The data resulting from a singular internal audit is of no use in establishing a viable trend. This data must be used in conjunction with the constraints placed upon the credit union. Computing a future increasing growth trend is useless if the credit union has already reached its growth limits.

The availability of quick cash can be determined from an internal audit if the credit union knows what factors lending institutions consider before making loans. Lending institutions consider various factors, depending upon the institution, before extending quick cash. The majority of these factors concern the financial strength and stability of the credit union. All factors concerning the strength and the stability of the credit union are investigated and recorded during an internal audit. The most important financial data analyzed by lending institutions before extending funds is usually found on the balance sheet.

Appendix 2 contains all the data used by the majority of lending institutions. To determine the availability of quick cash, all the credit union needs to do is to determine the standards of measurement used by the lending institution and then apply the data on Appendix 2 to see where the credit union ranks in financial strength. This ranking should give a viable indication of the availability of quick cash.

Investment Decisions

To recapitulate what was presented earlier, investment decisions require seven types of information. These items of information can be briefly stated as follows:

1. future cash flow
2. loan demand in future
3. predicted future deposits
4. liquidity requirements
5. return from investments
6. return from loans
7. future need for large amount of funds

No attempt is made during the internal audit to predict the future cash flow. By referencing data presented by the audit, the future cash flow can be relatively accurately predicted. The cash flow of a credit union is influenced by six factors. These factors are deposits, withdrawals, interest paid on deposits, loans, interest paid on loans, and operating expenses. All of this data can be withdrawn from the results of an internal audit with the exception of withdrawals. This data is not available on a monthly basis, but on a quarterly basis through the use of Appendix 12. The amount of deposits and loans outstanding are directly available from Appendix 12. The amount of interest collected on loans can be determined from Appendix 8. The amount of interest paid on shares can be calculated by multiplying the percentage figure on Appendix 12, under percent expenses to total income, times the interest received figures on Appendix 8. Withdrawals which cannot be determined will be taken into consideration when computing the amount of the member's shares. From this data a future cash flow can be predicted. This is possible because characteristically, credit unions are slow to change. Future cash flows can be predicted relatively accurately on the basis of recent cash flows.

Loan demand in the future can be determined by using some method of trend analysis. The data needed is presented on Appendix 12. By referencing Appendix 12's from prior audits, the loan pattern over a period of time can be determined. If data is desired on a monthly basis instead of a quarterly basis, the data can be obtained by referencing Appendix 8. This worksheet displays loan balances by months. Seasonal or monthly variations can be more accurately considered when using this worksheet.

From the information obtained in an internal audit, future deposits can only be predicted on a quarterly basis using Appendix 12. No provision is made during the audit for recording past deposits on a monthly basis. Therefore, any prediction of future deposits will have to be made on a quarterly basis.

The determination of liquidity requirements is a financial decision within itself. The preceding section has covered how the internal audit could be used in determining liquidity requirements.

The income received from investments other than loans can be easily determined from the data presented on Appendix 2. Item 8 records the income from other investments. This return can be converted to a percentage basis by dividing the total of items 107, 118, 119, and 122, on Appendix 12, into the total return from investments. An individual return from each investment is not calculated by the audit.

The return from loans is calculated by the internal audit. This data is available in two forms. By searching back into the ledgers, the audit records the interest received from loans. Appendix 8 is the worksheet utilized for recording these figures. The individual monthly returns and the total yearly returns are presented. During the review of loan folders, the rate of return for each individual loan is recorded. From these rates of return, an average rate of return for all outstanding loans is computed. This is accomplished under the formula section of Appendix 8. This average rate of return is expressed as a percentage. This percentage figure would probably be much more useful than the dollar figure when attempting to compare alternative investment opportunities.

The future need for a large amount of funds is not specifically delved into. By reviewing some of the data determined by the audit, the need for a large expenditure of funds can often be resolved. Credit unions very seldom ever experience a need for a large expenditure of funds except for increasing the size of the facility used or for the replacement of equipment. The audit examines all equipment owned by the credit union and places a dollar value upon it for the purpose of determining a realistic rate of depreciation. When the dollar value of this equipment is assessed to be quite low in relation to its original cost, it can be assumed that the time for replacement is near. When the time for replacement is near, the credit union will experience an expenditure of funds which can be considered unusually high when compared to expenditures required for normal credit union operation. The only other large expenditure a credit union may incur is the need for increased working space. This information is not revealed by an internal audit and is usually considered an administrative decision.

Determining Interest Rates

To recall what was covered earlier, there are eight factors that must be considered when making decisions concerning interest rates to be charged on loans. These factors stated briefly are as follows:

1. competitive rates
2. expenses of credit union
3. demand for loans
4. amount of deposited funds
5. rate credit union can borrow funds at
6. do you want to decrease or increase loan demand
7. how much surplus will remain after expenses plus dividends
8. security of the loan

Competitive rates cannot be determined from an internal audit. The interest rates of competitors are external factors. If competitors change their interest rates, the effects of such a change may be reflected by the audit. If competitors should lower their interest rates while yours remain the same and you experience a subsequent noticeable drop in loan demand, you may be able to determine the degree of sensitivity to which your loan demand is influenced by competitive rates.

The expenses of the credit union can be determined by the internal audit. The operating expenses section of the audit reveals detailed information about the expenses of the credit union. The important information to be cognizant of is not past expenses, but what the predictions are of future expenses. These are the expenses that are important when determining interest rates. The audit analyzes all expenses and compares them to expenses from previous years. It also compares them to expenses of comparable credit unions. From this analysis, the audit attempts to determine what expense trend the credit union is following. From this information a reasonable prediction can be made concerning expenses in the future.

The demand for loans in the future can be predicted based on the information obtained from an internal audit if the credit union has been following the policy of extending loans to all applicants who are financially qualified. Appendix 8 presents the loan levels from previous periods. For data further back than presented by this worksheet, the worksheets from previous audits may be referenced. The worksheets display the monthly loan levels. From an analysis of these loan levels in conjunction with loan levels of previous years, a reasonable anticipation of future loan demand can be made.

As mentioned under the liquidity section, future deposit or share levels can only be predicted on a quarterly basis. This data is needed to ensure that adequate funds are available to cover loan demand. Reliable information on a quarterly basis is dependable enough to ensure that adequate funds are available to cover loan demand.

Many credit unions loan out more funds than are deposited with the credit union. These additional funds are borrowed from other institutions. The interest rate at which the credit union can borrow these additional funds is largely determined by its financial condition. The internal audit presents all the indicators of financial strength and stability on Appendixes 2 and 12. Lending institutions evaluate credit unions in order to determine their financial stability. The credit union can apply these tools to evaluation based on the information supplied by the audit. The results of this evaluation will supply the credit union with valuable insights as to the rate of interest at which it can expect to borrow funds.

The decision as to whether the credit union desires to increase, decrease, or allow loan demand to remain the same, can be determined on the basis of the results of the audit. As a matter of general policy, a credit union states what the relationship will be between funds on deposit and funds loaned out. A credit union will attempt to stay within these constraints. Item 16 on Appendix 12 represents the relationship between deposits and shares. Based on this relationship, it can be determined how well within the desired constraints the loan-share balance falls. Based upon this location a decision can be made on whether loan demand should be increased or decreased.

The question of how much surplus will remain after expenses plus dividends can be resolved, allowing for the assumption that the credit union has already determined what its dividend rate will be. Once the dividend rate has been determined, the dividend payout can be computed by multiplying the rate times the amount of member's shares, item 12, recorded on Appendix 12. The expenses of the credit union are obtainable from the cost analysis and cost control portion of the audit as discussed previously. The dividends plus expenses should be subtracted from total income, available from Appendix 8, which will result in surplus. To find the total surplus this figure should be combined with the total reserve figure on Appendix 12. This will leave the total surplus the credit union has remaining after paying dividends and expenses.

The ability of the individual borrower to pay back a loan cannot be determined from the internal audit. An analysis of charged-off and uncollectable loans is made on Appendix 7. By reviewing a large enough sample of these faulty loans, some generalizations could be drawn on the types of loans most likely to fail. These generalizations could be applied to applications for future loans. This could provide some insight as to what the probability of a certain loan failing would be.

Dividend Decision Making

In order to determine optional dividend rates, seven kinds of information are needed. These seven kinds of data can be briefly stated as follows:

1. importance of dividends in regard to stability of shareholders
2. liquidity requirements of the credit union
3. the ability to borrow
4. timing of investment opportunities
5. impact of inflation on the replacement of assets
6. legal restrictions
7. long term capital requirements

A good insight as to the relationship between dividends and the stability of shareholders can be gained through the use of an internal audit. Appendix 12 presents the number of members, the number of potential members, and the percentage of actual members to potential members. By comparing the change in the number of members to the dividend rates of the credit union, an understanding of their interrelationship is obtainable. Dividends are paid quarterly as are the statistics on members computed quarterly. For a closer understanding of the relationship between these two variables, the data should be compared over a lengthy period of time. This additional data is available from the records of prior internal audits.

The determination of liquidity requirements is a large financial decision area within itself. This chapter previously discussed how the data available from an internal audit could be utilized in decision making concerning liquidity requirements.

The ability of the credit union to borrow can be calculated similarly to the methods presented, for determining the availability of quick cash and the rate of interest the credit union may borrow at, earlier in this chapter. The same techniques apply using the same sources of data presented previously.

The timing of investment opportunities is an external factor. An internal audit has no means of shedding information on these factors.

The internal audit can reveal partially the information needed to determine the impact of inflation on the replacement of assets. Credit unions often appropriate funds for the replacement of equipment based on the depreciation rate used for that equipment. The internal audit analyzes this rate to ensure that it is occurately based on the value of the asset. To guard against the impact of inflation, this depreciation rate must be compared with the replacement value of these assets, which is only available from outside sources. If the depreciated value of the asset is less than replacement costs, additional funds will have to be appropriated.

The internal audit has no relationship with the legal restrictions placed upon dividends. The federal law states that the maximum dividend rate is six percent.

A credit union would only encounter one type of long term capital requirement. This requirement would be the replacement of, or addition to, an office building. An internal audit can shed no information on the need for this capital requirement because it is considered soley an administrative need and is not investigated by the audit.

CHAPTER V

SUMMARY AND CONCLUSIONS

An internal audit of a credit union is not designed for the purpose of providing information for financial decision making. It can, however, provide valuable information for this purpose. Below is a list of the kinds of data required for financial decision making. Beside each item is an indicator of whether this information is available, partially available, or not available from an internal audit.

1.	competitive interest rates	no
2.	credit union expenses	yes
3.	demand for loans in future	yes
4.	deposited funds in future	yes
5.	rate at which credit union can borrow funds	partially
6.	need to increase or decrease loan demand	yes
7.	surplus remaining after expenses plus dividends	yes
8.	reliability of the loan	partially
9.	cash flow predictions	yes
10.	return from investments	yes
11.	return from loans	yes
12.	future capital requirements	partially
13.	seasonal fund requirements	yes
14.	number of large depositors	no
15.	population changes	no
16.	competitive developments	no

17.	growth pattern of credit union	yes
18.	national economic conditions	no
19.	availability of quick cash	partially
20.	importance of dividends to shareholder stability	yes
21.	ability to borrow long term funds	yes
22.	timing of investment opportunities	no
23.	impact of inflation on asset replacement	partially
24.	legal restrictions	no

An analysis of this list reveals that of the different kinds of data required for credit union financial decision making, forty-six percent of it can be obtained from an internal audit. The list also reveals that twenty-five percent of the information can be partially obtained. Twenty-nine percent of the needed information cannot be obtained from an internal audit.

The fact that seventy-one percent of the needed information is obtainable, fully or partially, from an internal audit does not infer that this material is easily obtainable. Much of this data is only available after performing extensive calculations on the data recorded by the audit. Because of the nature of some of these calculations, the resulting information cannot be considered totally reliable. The information used for the calculations can be considered reliable, but the information obtained from the calculations can only be considered as predictions in many cases. Nevertheless, these predictions are the best information available, regardless of other sources. Any information concerning trends or future operations are only predictions. They are only as dependable as the information used to derive them.

This paper does not mean to imply that the information needed for credit union financial decision making is only available from an internal audit. Nearly all the information can be obtained from credit union records. Obtaining some of this information from credit union records would require many hours of research. Information that would be particularly difficult to obtain would be that of prior periods needed for trend analysis. This would require searching through old credit union records.

This study concludes that most of the internal information needed for credit union financial decision making can be obtained from an internal audit. The advantage in using the internal audit as a source of information is the ease in which the needed information can be obtained in comparison with other methods of obtaining the information.

FCU 714 (Rev. 7-69)

APPENDIX 1

____________________ Federal Credit Union

INTERNAL CONTROL CHECK LIST

The audit procedures and work papers, where appropriate, provide for the supervisory committee to test and analyze internal controls with each audit step. To assure complete coverage, however, the committee should make a survey of internal controls at least annually, preferably at the time of the comprehensive annual audit. This form should be completed in two copies, with one copy transmitted to the board of directors and the other retained with the records of the supervisory committee.

All questions should be answered "Yes", "No", or "Not Applicable." Any questions which are answered "No" should be followed up by at least one member of the supervisory committee until appropriate correction has been made.

For further information refer to the discussion of internal controls in Section I of the Supervisory Committee Manual and the same subject in the Handbook for Federal Credit Unions and the Accounting Manual.

CONTROL OF CASH RECEIPTS AND CASH ON HAND

1. Does each employee handling funds effectively utilize his own lockable cash drawer or cash box? . . . . ________
2. Are spare keys to cash drawers or boxes kept under appropriate control? . . . . ________
3. Is there appropriate receipting for transfers of funds between employees when there is more than one employee concerned with the custody and responsibility for funds? . . . . ________
4. Are change funds maintained in amounts authorized by the board of directors and are they established on the records and replenished in the manner prescribed by the Accounting Manual? . . . . ________
5. Are adequate precautions taken to prevent credit union funds from being comingled with personal funds or other funds under control of credit union personnel? . . . . ________
6. Are cash received vouchers properly prepared when members make payments to the credit union? . . . . ________
7. Do the members receive receipts for payments made to the credit union? . . . . ________
8. As checks are received, are they immediately stamped with a restrictive endorsement (i.e. "For Deposit Only")? . . . . . ________
9. Are cash receipts balanced daily and entered in the Journal and Cash Record as of the day on which they are received? ________
10. Are cash over and short items recorded accurately each day and are such items reviewed at least monthly by the board of directors? . . . . ________
11. Are periodic surprise cash counts made by a supervising employee? . . . . ________
12. Are adequate safekeeping facilities provided for all cash and other liquid assets in the custody of the credit union? . . ________
13. Are bank deposits prepared by an official or employee who does not serve as teller? . . . . ________
14. Are bank deposits made intact within the time limits prescribed in the bylaws? ("Intact" means all of the cash collections and all of the checks received in the period covered by the deposit are deposited together.) . . . . ________

CONTROL OF DISBURSEMENTS

1. Are disbursements made by check or in accordance with disbursement procedures authorized by the board of directors, and are such disbursements properly recorded in the records? . . . . ________
2. Do the minutes of the board of directors contain an up-to-date record of the names of all officials and employees who are authorized to sign credit union checks? . . . . ________
3. Are adequate measures taken to prevent checks from being signed or countersigned in blank? . . . . ________
4. Are share withdrawals by borrowers and comakers approved by the credit committee or loan officer as specified by the bylaws? . . . . ________
5. Are loans disbursed only after completed and signed applications have been approved by the credit committee or loan officer and are properly signed notes on hand in support of the loans? . . . . ________

6. Are adequate measures in effect to prevent loans being disbursed by the loan officer who approved the granting of the loan? .... ______

7. Are withdrawals fom inactive share accounts verified by an official other than the official or employee making the disbursement? .... ______

8. Are invoices and other supporting documents attached to checks before the checks are signed? .... ______

9. Are invoices and bills for credit union expenses and capital expenditures marked paid with the date of payment to prevent their being used more than once to support a disbursement? .... ______

10. Are spoiled or voided checks properly accounted for and retained? .... ______

11. Are bank reconcilements prepared monthly by persons not directly concerned with handling credit union funds and recording them on the records? .... ______

12. Does the supervisory committee periodically obtain bank statements directly from the bank and reconcile them with the records of the credit union? .... ______

MAINTENANCE OF RECORDS

1. Are all financial records of the credit union maintained in ink or by machine? .... ______

2. Are all corrections in financial records made in such manner that the change can later be verified? .... ______

3. Are the vital accounting records kept in fire resistant containers? .... ______

4. Minutes of directors' and membership meetings:

   a. Are they prepared promptly in permanent form? .... ______

   b. Do they reflect accurately the actions taken? .... ______

   c. Are they read and approved at the next meeting? .... ______

5. Minutes of credit committee meetings and reports of loan officer actions:

   a. Are they prepared promptly in permanent form? .... ______

6. Is the file of members' signature cards (applications for membership) maintained currently? .... ______

7. Are mailing addresses of members maintained up-to-date? .... ______

8. Are loan documents completed by ink or typewriter before signatures are added? .... ______

9. When loans are paid are the notes marked "paid" and promptly returned to the members? .... ______

10. Is repossession and sale of collateral controlled and supervised by the board of directors and are the transactions involving such activity clearly reflected on the records in accord with the instructions in the Accounting Manual? .... ______

11. If the credit union uses window posting or teller machine(s):

   a. Does each teller have a key (teller's symbol) for his exclusive use? .... ______

   b. Is maximum utilization being made of the built-in control devices in the machine(s), such as locks, and keys, counters or dials, and tellers' symbols? .... ______

   c. Is access to the machine by-product (journal or proof sheet) limited to supervisory personnel? .... ______

12. Is a list of new members and withdrawn members furnished to the board of directors and to the supervisory committee each month? .... ______

13. Are employees who are assigned to post specific blocks of members' accounts rotated from time to time? .... ______

14. Are monthly share and loan trial balance tapes prepared by employees other than those who post the accounts? .... ______

15. Is the balancing of share and loan accounts with General Ledger controls and the maintenance of the Journal and Cash Record and the General Ledger assigned to employees who do not serve as tellers? .... ______

16. Are share accounts in which there has been no activity (except dividends) for a year or more segregated from the active accounts? .... ______

17. If the credit union engages in the sale of travelers' checks or money orders are inventory listings maintained of the checks and money orders? .... ______

CONTROL OF LOAN DELINQUENCY

1. Is a complete and accurately classified report of delinquent loans prepared each month and reviewed by the board of directors or by a special committee of the directors? .... ______

2. Does each monthly Financial and Statistical Report contain an accurate and complete classification of delinquent loans? .... ______

3. Does the supervisory committee confirm the outstanding balances of loans of delinquent borrowers in the hands of collection agencies or attorneys? .... ______

CHARGED-OFF LOANS

1. Does approval for the charge-off of each loan determined to be uncollectible by the board of directors appear in the minutes of the board? .... ______

2. Are charged-off loans reviewed by the board of directors at least semiannually? .... ______

3. Are reports on recoveries of charged-off loans regularly made to the directors? .... ______

INVESTMENTS

1. Do the minutes of the board of directors and the executive committee contain prior approval for changes in the credit union's investments? .... ______

2. Are adequate safekeeping facilities provided for investment securities? .... ______

3. If investment securities are maintained in a safe deposit box, are at least two officers, acting jointly, required to gain access to the safe deposit box? .... ______

SAFETY PRECAUTIONS

1. Is cash kept in a secure fire and burglary resistant safe or vault? .... ______

2. Are safe-keeping facilities adequate for the normal amount of cash on hand? .... ______

3. Is possession of the combination for unlocking the safe limited to no more than two persons? .... ______

4. Is the combination to the safe changed when a person having knowledge of it leaves the employ of the credit union? ______

5. Are door locks changed each time a person with access to the keys leaves the employ of the credit union? .... ______

6. Is each teller's cash kept to the smallest practicable minimum at all times? .... ______

7. Is the bulk cash kept locked in the safe until needed? .... ______

8. Is a night-light kept burning near the safe or vault during non-business hours? .... ______

9. Does the credit union have police or security guard protection when handling or transporting large sums of money? ______

10. Are training sessions conducted periodically for credit union officials and employees concerning procedures and practices intended to deter robberies and burglaries? .... ______

CREDIT UNION PERSONNEL

1. Are employees carefully selected on the basis of interviews, detailed applications, and references? .... ______

2. Is each employee provided with his job description clearly setting forth his duties and responsibilities? .... ______

3. Are officials and employees who handle or have access to funds and securities and who maintain records required to take vacations at least annually? .... ______

4. Are employees' duties rotated from time to time wherever possible? .... ______

5. Are employees trained to perform each other's duties? .... ______

6. Is the salary scale approved by the board of directors and is approval recorded in the board's minutes? .... ______

MEMBERSHIP

1. Are adequate and appropriate efforts made on a continuing basis to keep members informed concerning the following:
   a. Purpose of the credit union? . . . . ______
   b. Progress of their credit union? . . . . ______
   c. Purpose and importance of account verification by the supervisory committee? . . . . ______
   d. Duties of the officers, directors and committeemen? . . . . ______
   e. Important changes in policies, procedures and office hours? . . . . ______
2. Are complete Financial and Statistical Reports posted each month where they may be read by the members? . . . . ______
3. If passbooks are used, are members required to retain their own passbooks and present them when transacting business with the credit union? . . . . ______
4. If statements of account are used, does the supervisory committee investigate incoming mail to the credit union shortly after statements have been distributed? . . . . ______

MISCELLANEOUS

1. Does the board of directors review surety bond and other insurance coverage to determine adequacy to meet the needs of the credit union as well as, for surety bond coverage, to meet the minimum standards prescribed by the Rules and Regulations of the Bureau of Federal Credit Unions? . . . . ______
2. Does the supervisory committee confirm transactions involving life savings and borrowers insurance claims, with the insurance company and the beneficiaries? . . . . ______
3. Are the manuals and instructional materials furnished by the Bureau of Federal Credit Unions made accessible to the officials for reference and study? . . . . ______
4. Are the annual and semiannual audit reports of the supervisory committee reviewed and discussed by the board of directors promptly after completion? . . . . ______
5. Are the Supervisory Examination Reports furnished by the Bureau of Federal Credit Unions reviewed at a joint meeting of the officials? . . . . ______
6. Is the action taken by the board of directors on recommendations made by the supervisory committee and the Federal credit union examiner recorded in the minutes? . . . . ______

Prepared by: ______________________________ Date: ______________

.... Federal Credit Union

GENERAL LEDGER TRIAL BALANCE

As Of .... Prepared By: ....

NAME OF ACCOUNT	PER BOOKS		ADJUSTMENTS		ADJUSTED BALANCE	
	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT
Loans						
Cash						
Petty Cash						
Change Fund						
U. S. Government Obligations						
Savings and Loan Shares						
Loans to Other Credit Unions						
Furniture, Fixtures and Equip.						
Prepaid Insurance						
Other Assets						
Land and Building						
Shares or Deposits in Other CU's						
Federal Agency Securities						
Common Trust Investments						
Loans Purchased from Liq. CU's						
Expense Control						
Accounts Payable						
Notes Payable						
Withholding Taxes Payable						
Social Security Taxes Payable						
Unemployment Comp. Taxes Payable						
Shares of Nonmembers						
Shares						
Regular Reserve						
Special Reserve for Delin. Loans						
Reserve for Contingencies						
Supplemental Reserve						
Undivided Earnings						
Gain or Loss						
Interest on Loans						
Income from Investments						
Other Income						
TOTAL						

(See Section VI of the Supervisory Committee Manual for information on completing this work paper.)

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.... Federal Credit Union

TRIAL BALANCES OF INDIVIDUAL SHARE AND LOAN LEDGERS

Prepared by: ....

A. CURRENT BALANCES

	LOANS	SHARES
1. Balances per General Ledger as of ________ (date) ________	________	________
2. Totals per committee's trial balances, or adjusted totals if reconciliation was necessary	________	________
3. Differences, if any. (Analyze below)	________	________

B. ANALYSIS OF DIFFERENCES FOR THE PREVIOUS 3 MONTHS

Dates	(________)	(________)	(________)
Loans			
4. Balances per General Ledger	________	________	________
5. Totals per treasurer's listings	________	________	________
6. Differences	________	________	________
Shares			
7. Balances per General Ledger	________	________	________
8. Totals per treasurer's listings	________	________	________
9. Differences	________	________	________

Describe below actions that have been taken by operating personnel to correct differences, if any, shown in Sections A and B.

____

____

____

____

____

____

(See Section VI of the Supervisory Committee Manual for information on completing this work paper.)

.... Federal Credit Union

CASH COUNT

As of ....

Prepared by: ....

	PETTY CASH		GENERAL CASH		Checks and Money Orders	
	NO.	AMOUNT	NO.	AMOUNT	IDENTIFICATION	AMOUN
s						
s						
ds						
describe):						
currency, and cash items						
and money orders						
hand						
Change funds						
general cash receipts						
t of Cash Received ce last bank deposit					Total	

RECEIPT

RTIFY that funds shown on the **"Total on hand"** line were counted by .... for the supervi my presence this .... day of ...., 19......, at .... (a.m., p.m.) and returned to me intact. T nt all undeposited funds of the credit union for which I am accountable.

....
Title

(See Section VI of the Supervisory Committee Manual for information on completing this work paper.)

PRINTED IN U.S.A.

................................Federal Credit Union

BANK RECONCILEMENT

f .... Prepared by: ....

.... of ....

Name of Bank City State Zip Code

Section A

K BALANCE PER BOOKS OF CREDIT UNION	
BOOKS	
by bank but not yet ooks of credit union	
SUBTOTAL	
by bank but not yet oks of credit union	
TOTAL DEDUCTIONS	
ADJUSTED TOTAL	

Section B

BANK BALANCE PER BANK STATEMENT

BALANCE PER BANK STATEMENT ________ (Date)

DEDUCTIONS:

OUTSTANDING CHECKS

Check No.	Amount	Check No.	Amount

TOTAL OUTSTANDING CHECKS	
SUBTOTAL	
ADDITIONS Items added by credit union but not yet entered on the bank's records DEPOSITS IN TRANSIT: (Show dates of summary Cash Received Vouchers)	
UNDEPOSITED CASH ON HAND	
OTHER ADDITIONS	
ADJUSTED TOTAL	

____________________ Federal Credit Union

LOAN EXCEPTIONS

As of __________________ Prepared by: __________________

ACCOUNT NUMBER AND NAME OF BORROWER	DATE OF LOAN	UNPAID BAL-ANCE AS OF AUDIT DATE		COMMENTS	FOLLOW-UP	
					CORRECTED (√)	CHECKED BY

Explanation of Symbols

AL—Application for Loan
CC—Credit Committee
COL—Collateral
CM—Chattel Mortgage
CO—Comaker, Cosigner
CT—Certificate of Title
FS—Financing Statement
HHG—Household Goods
INS—Insurance; Insurance Policy
LO—Loan Officer
LP—Loss Payable Clause
M—Minutes
N—Note
SA—Security Agreement; Other Lien Instrument
SL—Secured Loan Limit
UNS—Unsecured Loan Limit

(See Section VI of the Supervisory Committee Manual for information on completing this work paper.)

APPENDIX 7

. . . . .Federal Credit Union

CHARGED-OFF LOANS AND RECOVERIES

d From. . . . . 19. . . . To. . . . . 19. . . .   Prepared by: . . . .

OUNT NUMBER AND ME OF BORROWER	Amount of—			Date Board Voted Charge-Off	Type of Collateral *	Collateral Converted? Yes/No	Atty. or Collection Agency Used? Yes/No	COMMENTS (Use reverse side for additional comments.)
	Original Loan	Charge-Off	Recoveries					
Other Charged-Off Loans and coveries During Period (Totals)								
TOTALS (To FCU 715)								

*Type of Collateral Code (Show principal type or types)

0—Unsecured
1—New Automobiles and Trucks, Boats and Trailers
2—Used Automobiles and Trucks, Boats and Trailers
3—Household Furnishings and Appliances
4—Business Fixtures, Farm Mach. and Equip., Livestock
5—Real Property
6—Comakers
7—Shares
8—Other (Identify in "Remarks" section)

(See Section VI of the Supervisory Committee Manual for information on completing this work paper.)

..................................Federal Credit Union

GROSS TEST INTEREST ON LOANS AND INTEREST REFUNDS

From.............. 19.... To.............. 19....   Prepared by: ....

GROSS TEST INTEREST ON LOANS					
dger Loan Balances	______ 19__	______ 19__	______ 19__	______ 19__	______ 19__
—	$	$	$	$	$
als					
ula:					
erest le	$	$	$	$	$
erest Collected	$	$	$	$	$
ce	$	$	$	$	$
ce (%)	%	%	%	%	%
of Individual calculations					

GROSS TEST INTEREST REFUNDS					
Refund	Period (%) Ending____19__	Period (%) Ending____19__	Period (%) Ending____19__	Period (%) Ending____19__	Period (%) Ending____19__
erest collected period	$	$	$	$	$
m interest payable	$	$	$	$	$
erest refund paid	$	$	$	$	$
ce (%)	%	%	%	%	%
of individual ons					

(See Section VI of the Supervisory Committee Manual for information on completing this work paper.)

APPENDIX 9

.... Federal Credit Union

RESERVES AND UNDIVIDED EARNINGS

As of .... Prepared by ....

REGULAR RESERVE	ADDITIONS	DEDUCTIONS	BALANCES
t audit ______, 19____			
,* of gross income, period ended ______			
,* of gross income, period ended ______			
,* of gross income, period ended ______			
,* of gross income, period ended ______			
* as required by section 116 of the FCU Act			
on bad loans (From FCU 716)			
ons (List source and dates)			
______ ______, 19____			
______ ______, 19____			
l			
harged-off (From FCU 716)			
tions (List source and dates)			
______ ______, 19____			
______ ______, 19____			
l			
______, 19____, effective date of audit			
UNDIVIDED EARNINGS			
audit ______, 19____			
et earnings after above transfers to Regular Reserve for			
riod ended ______, 19____			
riod ended ______, 19____			
riod ended ______, 19____			
riod ended ______, 19____			
r from other reserve accounts (see reverse for breakdown of transfers)			
ons (List source and dates)			
______ ______, 19____			
______ ______, 19____			
l			
id ______, 19____, Rate ______%			
id ______, 19____, Rate ______%			
id ______, 19____, Rate ______%			
id ______, 19____, Rate ______%			
rs to other reserve accounts (see reverse for breakdown of transfers)			
ons (List source and dates)			
______ ______, 19____			
______ ______, 19____			
l			
______, 19____, effective date of audit			

VI of the Supervisory Committee Manual for information on completing this work paper. Complete the reverse side of this when the FCU has any additional reserves.

SPECIAL RESERVE FOR DELINQUENT LOANS	ADDITIONS	DEDUCTIONS	BALANCES
alance as of last audit ____________, 19____			
dditions:			
From Undivided Earnings for			
period ended ____________, 19____			
period ended ____________, 19____			
period ended ____________, 19____			
period ended ____________, 19____			
Other Additions (List source and dates)			
____________ ____________, 19____			
____________ ____________, 19____			
Subtotal			
eductions:			
To Undivided Earnings for			
period ended ____________, 19____			
period ended ____________, 19____			
period ended ____________, 19____			
period ended ____________, 19____			
Other Deductions (List source and dates)			
____________ ____________, 19____			
____________ ____________, 19____			
Subtotal			
alance ____________, 19____, effective date of audit			
ANALYSIS OF OTHER RESERVE ACCOUNTS			
ame of Account ____________			
alance as of last audit ____________, 19____			
dditions (List source and date)			
____________, 19____			
____________, 19____			
Subtotal			
eductions (List source and date)			
____________, 19____			
____________, 19____			
Subtotal			
alance ____________, 19____, effective date of audit			
ame of Account ____________			
alance as of last audit ____________, 19____			
dditions (List source and date)			
____________, 19____			
____________, 19____			
Subtotal			
eductions (List source and date)			
____________, 19____			
____________, 19____			
Subtotal			
alance ____________, 19____, effective date of audit			

FCU 713

APPENDIX 10

____________ Federal Credit Union

LIST OF MEMBERS' ACCOUNTS AND RECORD OF VERIFICATIONS

ACCOUNT NUMBER	NAME	DATE ACCOUNT OPENED	DATE ACCOUNT CLOSED	VERIFICATION DATE				
				ACTION TAKEN				

.... Federal Credit Union

LIST OF MEMBERS' ACCOUNTS AND RECORD OF VERIFICATIONS

ACCOUNT NUMBER	NAME	DATE ACCOUNT OPENED	DATE ACCOUNT CLOSED	VERIFICATION DATE / ACTION TAKEN				

.... Federal Credit Union
....
....
....

....
....
....

Gentlemen:

For the purpose of facilitating our audit, it will be appreciated if you will verify the information shown below. IF ANY OF THE INFORMATION SHOWN IS INCORRECT, PLEASE DRAW A LINE THROUGH IT AND ADD THE CORRECT INFORMATION AS SHOWN BY YOUR RECORDS. An addressed envelope is enclosed for your reply.

Information authorized by— Very Truly yours,

....
CHAIRMAN, SUPERVISORY COMMITTEE

Information for the period from.. to ....

concerning all loans made during this period as well as loans outstanding on the latter date with the ....

.... Federal Credit Union

DATE	AMOUNT LOANED	AMOUNT BORROWED	AMOUNT REPAID	UNPAID BALANCE	TERMS OF NOTE	INTEREST RATE	INTEREST PAID OR RECEIVED

If any security has been pledged on above loans, please list such security on reverse.

Correct, except as indicated

....

...., 19.......... By ....
(SIGNATURE AND TITLE)

APPENDIX 12

.... Federal Credit Union

TRENDS

(Financial Condition and Service to Members)

Year..............................

	For the Period Ending			
	March 31	June 30	September 30	December 31
ssets				
.mount of Loans				
of Delinquent Loans				
Delinquent Loans to Total Amount of Loans	%	%	%	%
Requirement				
eserves				
Reserves to Shares	%	%	%	%
Reserves to Loans	%	%	%	%
r of Loans				
e Amount of Outstanding Loans				
of Members				
of Members' Shares				
r of Potential Members				
Actual Members to Potential Members	%	%	%	%
e Shares per Member				
Loans to Shares	%	%	%	%
Payable				
Expenses to Total Income—to Date	%	%	%	%
Expenses to Total Income—Same Last Year	%	%	%	%

(See suggestions on reverse for completing this Work Paper.)

TRENDS (Financial Condition and Service to Members) (FCU 708

THIS CONTINUING WORK PAPER IS DESIGNED TO FACILITATE THE COMMITTE'S ANALYSIS OF CERTAIN SIGNIFICANT TRENDS IN OPERATIONS. (SEE THE SUPERVISORY COMMITTEE MANUAL.) THE WORK PAPER COVERS THE PERIODS ENDING ON THE FOUR CALENDAR QUARTERS.

CUMULATIVE FIGURES AND RATIOS ON THIS WORK PAPER SHOWN FOR EACH CALENDAR QUARTER-END SHOULD BE COMPARED WITH THE FIGURES AND RATIOS IN THE MOST RECENT ANNUAL REPORT OF OPERATIONS ISSUED BY THE BUREAU OF FEDERAL CREDIT UNIONS.

THIS WORK PAPER WILL BE PREPARED AS OF THE END OF EACH CALENDAR QUARTER. NORMALLY IT WILL BE PREPARED AS PART OF THE QUARTERLY AUDITS.

The information on the form will be developed as follows:

1. Items 1, 2, 3, 9, 11, 12, 13, and 17 from treasurer's Financial and Statistical Reports.
2. Item 4—divide amount of delinquent loans (item 3) by total amount of loans (item 2).
3. Item 5—Compute in accordance with instruction on page 86 of the Accounting Manual for Federal Credit Unions. Base on delinquency classification shown on treasurer's Financial and Statistical Report as of the quarter-end.
4. Item 6—Includes all reserves (General Ledger Accounts 311, 315, 316, and 318) shown on treasurer's Financial and Statistical Report.
5. Item 7—Divide total reserves (item 6) by members' shares (item 12).
6. Item 8—Divide total reserves (item 6) by total amount of loans (item 2).
7. Item 10—Divide total amount of loans (item 2) by number of loans (item 9).
8. Item 14—Divide number of members (item 11) by potential members (item 13).
9. Item 15—Divide members' shares (item 12) by number of members (item 11).
10. Item 16—Divide total amount of loans (item 2) by members' shares (item 12).
11. Item 18—Divide total expenses shown on treasurer's Financial and Statistical Report for the quarter-end by total income shown on the same report. (Note: If books are closed semiannually, the committee should combine information on appropriate financial and statistical reports to arrive at total income and expense for periods ending in the last half of the year.)
12. Item 19—Show percentage for corresponding quarter-end on previous year's work paper of Trends (Financial Condition and Service to Members).

| 701 (Rev. 7-69) ______________ Federal Credit Union

______________ City ______________ State ______________ Charter No. ______

SUPERVISORY COMMITTEE COMPREHENSIVE ANNUAL AUDIT REPORT

the period beginning ______________, 19____ and ending ______________, 19____

s report will be prepared upon conclusion of the comprehensive annual audit. The date for "period beginning" will be the day folving the effective date of the previous comprehensive annual audit. Separate sheets covering comments and recommendations uld be attached. A copy of this report should be furnished promptly to the board of directors; the original, together with all ated workpapers, should be retained by the supervisory committee in its confidential files.

SH

Did the cash count disclose any questionable items? .... ______

Were all cash receipts accounted for in the period(s) tested? .... ______

Was the cash account reconciled each month with the balance reported by the bank? .... ______

Have cash receipts been deposited in the bank within the time limitations prescribed in the bylaws? .... ______

Have cash received vouchers been prepared properly and summarized daily? .... ______

Were all canceled checks that were examined signed properly and did all endorsements appear to be proper? .... ______

Were all disbursements that were examined made in accordance with the procedures prescribed in the Accounting Manual for Federal Credit Unions? .... ______

Were confirmation letters mailed to all banks with which the credit union has an account? .... ______

ENERAL LEDGER AND INDIVIDUAL SHARE AND LOAN LEDGERS

Was the General Ledger in balance as of the effective date of this audit? .... ______

	Shares	Loans
Balances in General Ledger as of the effective date of this audit	$______	$______
Totals of committee's trial balance tapes(after adjustment if reconciliation was necessary)	$______	$______
Differences (if any)	$______	$______

If differences exist, how long have the ledgers been out-of-balance? .... ______

What is being done to locate and correct the differences? ______________

(Use additional page to complete explanation if needed)

Are monthly trial balance tapes or listings of the Individual Share and Loan Ledgers prepared each month? .... ______

Were the Individual S[illegible] [illegible] Loan Ledgers posted through the last month-end? .... ______

ere dividends computed in accordance with the FCU Act, the bylaws, and the Accounting Manual for Federal Credit nions? . . . . ________

NSES

ave expenses been properly authorized by the board of directors? . . . . ________

e expenses supported by appropriate vouchers or invoices? . . . . ________

ITURE, FIXTURES AND EQUIPMENT; OTHER ASSETS AND LIABILITIES

ere acquisitions and disposals authorized by the board of directors and properly reflected in the accounting records? ________

the rate of depreciation authorized by the board of directors reasonable? . . . . ________

ere all other asset and liability accounts maintained in accordance with the instructions in the Accounting Manual for deral Credit Unions? . . . . ________

TY BOND AND OTHER INSURANCE COVERAGE

oes the blanket surety bond comply with the minimum schedule in Section 301.20 of Rules and Regulations? . . . . ________

oes the board of directors review the amount of surety bond coverage in effect at least semiannually to determine dequacy? . . . . ________

re all insurable hazards adequately covered by insurance? . . . . ________

re premiums paid currently on all insurance coverage? . . . . ________

ALL OPERATIONS

as correction been made of all exceptions disclosed by the:

Previous supervisory committee audits? . . . . ________

Most recent annual survey of internal controls? . . . . ________

Most recent Supervisory Examination Report? . . . . ________

ave accurate Financial and Statistical Reports been prepared each month and were they displayed in accordance with ovisions of the bylaws? . . . . ________

ave the board and the credit committee held meetings at least monthly? . . . . ________

re adequate minutes maintained of meetings of the members, the board of directors, the executive committee, and the edit committee? . . . . ________

re adequate measures taken to minimize exposure to robbery and burglary? . . . . ________

FICATION OF MEMBERS' ACCOUNTS

ave all of the members' accounts been verified within the past two years? . . . . ________

ection 16 of the FCU Act requires that all passbooks and accounts of members be verified with the treasurer's records at ast once each two years. More frequent verification is recommended.)

erifying members' accounts were the following general verification controls, discussed in the Supervisory Committee ual, followed?

urprise contact and physical control of records? . . . . ________

Treasurer or other operating personnel not used in verification program? . . . . ________

General notice of verification given to membership? . . . . ________

Confidential record of members' accounts maintained by committee? . . . . ________

Trial balance of members' ledgers by committee or its auditing assistants? . . . . ________

Direct communication between the committee and the members? . . . . ________

Record of members' accounts verified maintained by committee? . . . . ________

certify that this report is based on information obtained from the credit union's records and through direct observation by us or by auditors acting under our supervision and that, to the best of our knowledge and belief, the statements contained herein are correct. We further certify that adequate work papers have been prepared and retained all audit procedures related to this comprehensive annual audit.

(This section to be completed by the auditing firm or individual if the audit was not performed by the supervisory committee. The signature should be that of the person in charge of the audit or of the person who accepts appropriate responsibility for his firm.)

____
(Auditing Firm)

By: ________________________________

____
(Date)

THE BOARD OF DIRECTORS

If this audit was performed by an outside accountant or firm, the name and signature are shown above. In addition to subscribing to the above certification we, the supervisory committee members, further certify that whether we performed this audit or caused it to be made, we discharged our responsibilities in all areas of the audit.

____
(Date)

Signed: ________________________ (Chairman)

________________________ (Member)

(This section must be signed by at least a majority of the members of the supervisory committee.)

________________________ (Member)

________________________ (Member)

________________________ (Member)

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