

Omnipro - Credit Union Conference 2013

Loan Book Reviews
& PRISM Visits
17 September 2013

About FMB

- Leading auditor to Credit Unions (23)
- Acting as auditors for over 25 years
- Involved in transfer/amalgamations
- Central Bank directed assets and loan book reviews
- Year end Loan Book reviews
- Review of Value in use calculations
- Investment reviews
- PRISM meetings
- Supervisory committee work for non-audit credit unions
- Internal Audit Function

Who am I

- David McArdle, FCA
 - Started training in 1988 in FMB
 - Qualified Accounting Technician in 1990
 - Qualified Chartered Account in 1996
 - Partner in 2001
 - Audit Engagement partner (Currently for 8 Credit Unions)
 - Advising Credit Unions for 25 years

Who am I

- Patrick Loughnane, ACA
 - Commenced training in FMB in 2003
 - Qualified Chartered Accountant 2007
 - Senior manager in charge of Credit Unions since 2006
 - Attended all our PRISM engagements

Areas to be covered

- Loan Book Reviews
- PRISM Reviews

Loan Book Review

- Types of request
 - Central Bank
 - Credit Union
- Types of request made by Central Bank
 - Template to be completed and reviewed by auditor
 - Independent Loan Book review
 - Auditor to carry out loan book and asset review as part of year end work

Note – Central Bank normally review to include a review of lending policies/procedures review, investment review, fixed asset valuation review, governance

Guidance/Legislation

- Guidance Note on Credit and Credit Control for Credit Unions – October 2007
 - Provisioning Policy in relation to bad and doubtful debts should be clearly documented (7.4)
 - Res 49 should be regarded as the minimum level of provision required. (7.6)
 - Review of loan book at least quarterly and any adjustments incorporated in the management accounts. (7.7)

Guidance/Legislation

- Section 35 – Regulatory Requirements for Credit Unions November 2010
 - CU must ensure they review their total loan portfolio on a quarterly basis to verify the adequacy of the BDP and incorporate resulting adjustment in monthly management accounts and Prudential Returns. (4.3)
 - A full review of the BDP must be undertaken as part of the year end annual accounts preparation and audit process. (4.4)

Guidance/Legislation

- Practice Note 27 (I)
 - ISA 540 – Audit of Accounting Estimates
 - Auditor’s review of CU methods for making provisions .. includes consideration of their reasonableness, consistency with prior years and conformity with generally accepted practices.
 - Auditor to ascertain that management have properly exercised their judgement, followed a consistently applied policy .. and not merely followed a standard formula/matrix calculation.

Guidance/Legislation

- Central Bank Circular to Credit Unions 23 August 2013
 - Boards expected to apply a conservative and realistic approach in the measurement of bad debt provisions
- Central Bank Circular to Auditors 2 September 2013
 - Professional scepticism

Engagement Letter

- Is a separate engagement letter required?
 - In most cases – YES
 - If reviewing Credit Union prepared Loan Book Review and template then perhaps no as part of audit work.

Central Bank Template request

- Complete 'Asset review findings summary template'
 - Must be discussed with auditor prior to accounts being finalised
 - Board to confirm in writing to CB that they will comply with the request and that they have discussed with the auditor
 - Must be uploaded via secure file upload with the draft accounts
 - Does not state who must complete the work. (Internally/League/Auditor ?)
- May have an impact on proposed AGM dates.
- Note CB will state that CU should not set an AGM date.

SECTION A: Loan book review

	Gross Loans €	Net Loans €	Loan class Reviewed (Yes/No)	Existing Specific Provision €	Additional Specific Provision from Review €	Total Specific Provision Requirement Post Review €	Balance Sheet Adjustment Required €
Specific BDP at date of review							
Analysis of additional BDP identified							
Top 100 Loans						€0	
Loans > €25,000						€0	
All Loans > 9 Weeks in Arrears						€0	
All Atypical & Lump Sum Repayment type Loans						€0	
All Rescheduled Loans in Previous 2 years						€0	
All Loans issued for Nominal Amounts						€0	
All Loans issued to cover Interest Outstanding						€0	
All Loans with > 1 Share to Loan transfer in Last 12 months						€0	
All Loans where additional credit has been extended on three or more occasions in the last two years (irrespective of whether the loan is currently performing)						€0	
All loans where temporary arrangements have been put in place with members.						€0	
All Loans granted for Commercial / Property purposes						€0	
Officers Loans						€0	
All Loans > 52 Weeks in Arrears						€0	
Loans to connected borrowers						€0	
A sample of gross loans greater between 5-9 weeks in arrears							
A sample of other loans eg: prepaid / not in arrears / in arrears 1-5 weeks							
All consolidation loans						€0	
All emergency loans in the last 2 years						€0	
All Loans with a maturity date over 10 years						€0	
Sample of Loans with a maturity date over 5 years						€0	
Total Loans	€0	€0					

Total Existing Specific Provisions			€0		
Total Additional Specific Provisions Identified from Review				€0	€0
Total Specific Provisions following Review				€0	
General Bad Debt Provisions prior to review					
Total Additional General Provisions Identified from Review					€0
Total General Provisions following Review				€0	
Total Bad Debt Provision requirement Post Review				€0	
Total Bad Debts requiring Write Off Post Review					
Is the credit union in compliance with Section 35 requirements? (Yes / No)					

Central Bank template

- Investment portfolio review

Not at maturity

SECTION B: Investment portfolio review				
	Investment Class Reviewed (Yes/No)	Existing Net Book Value €	Potential Impairment Requirement Post Review €	Net Realisable Value at Date of Review €
Irish & EMU State Securities				€0
Accounts in Authorised Credit Institutions				€0
Bank Bonds				€0
Investments in Equities				€0
Collective Investment Schemes				€0
Life Assurance Products				€0
Other (please specify):				€0
				€0
				€0
				€0
				€0
Total Existing Net Book Value		€0		
Total Potential Impairment Requirement Post Review			€0	
Total Net Realisable Value at date of Review				€0

Central Bank template

- Calculates 'potential impairment' based on NRV at date of review
- No account taken of products guaranteed at maturity

Central Bank template

- Fixed Asset review

SECTION C: Fixed asset review					
	Fixed Asset Valuation (e.g. Historical Cost/Other)	Fixed Asset Class Reviewed (Yes/No)	Existing Net Book Value €	Potential Impairment Requirement Post Review €	Net Realisable Value at Date of Review €
Credit Union Premises				€0	
Other Properties included in the Balance Sheet				€0	
				€0	
Total Existing Net Book Value			€0		
Total Potential Impairment Requirement Post Review				€0	
Total Net Realisable Value at date of Review					€0

Central Bank template

- Fixed Asset review
 - Calculates ‘Total Potential Impairment’ based on a current NRV
 - No account for value in use.

Loan Book Review

- Independent Loan book review
- Auditor to carry out a Loan Book review

Loan Book Review - Reports

- Report from Member Transaction System
 - Member Name, Member Number, Member address (for use on connected parties review), Gross Loan balance, Share balance, Net Loan balance, Resolution 49 provision, Loan purpose (personal / business / mortgage / emergency), Weeks in arrears, Principal arrears, Interest Due, Override provision, Loan issue date, Repayment amount, Repayment frequency, Last payment date, Last Payment amount, Number of payments in last 12 months, Number of times rescheduled, Date of last reschedule, Temporary arrangement, Officer, Security, Guarantor
- Listing of share to loan transfers processed in the financial year
- Listing of loans with temporary arrangements in place
- A listing of rescheduled loans in the past two financial years
- A listing of loans issued in the past two financial years
- A listing of officers loan balances

Categories to review – Central Bank

- Top 100 Loans
- Loans greater than €20k
- Loans over 9 week in arrears
- Lump Sum repayment loans
- Loans rescheduled in last 2 years
- Loans issued for nominal amount
- Loans issued to cover interest
- Loans with multiple share to loan transfers
- Loans where credit have been extended 3 or more time in last 2 year
- Temporary arrangements
- Loans for commercial/property purposes
- Officers Loans
- Loans greater than 52 weeks in arrears
- Loans to connected borrowers
- Consolidation loans
- Emergency loans in last 2 years

Other categories to review

- Prepaid loans including bullet repayments
- Loans with a long repayment terms
- Loans issued where member is near retirement age
- Loans to self employed
- Loans with repayment amendments

Note – some loans may be classified in a number of different categories. They would only be reviewed and reported in the first category they are identified in.

Methodology

- If loan is covered – generally no action
- If loan is already 100% provided – no action
- Remaining –
 - Look at expected number of repayments V's actual and if no arrears – generally no action
 - All remaining loans are subject to detailed review

Remaining loans

- Review members account for last 12 months.
- Missed repayment, returned DD's, reduced repayments
- Any account showing impairment will be escalated
 - Review of correspondences with Credit Control
 - Detailed review of members account (24 months)
- Review last internal/external LBR and see notes on the specific account
- Arising from that we make a determination of the appropriate provision
- Normally we would disregard external security as a reason not to apply a provision

Characterises of impairment

- Financial difficulties of the member communicated to the Credit Union
- The missing of payments by the member which constitute an actual breach of contract
- The granting of favourable terms to the member by the Credit Union, on a permanent or temporary basis, which may include spreading the loan over an excessively long term or granting a significant volume of top-up loans
- The granting of top-up loans to members on which the new repayment terms are lower than those on the original loan
- Poor history of repayments on the member's account
- Loans which may have been considered impaired in a previous financial period
- The failure of the project or business for which the finance was originally advanced
- Loan repayments being financed from share transfers rather than from external revenue streams
- The rescheduling of loan agreements as the member is nearing default, effectively amounting to extending the loan repayment period
- The suspension of interest on loans effectively amounting to a reschedule
- Payments being made in lump sums and not in line with the agreed repayment terms of the loan
- Where security in excess of the member's shares is in place, the adequacy and availability of such security and whether it is being used by the credit union to reduce provisioning requirements.

Provisioning

- Where we identify indication of impairment then the starting point is normally 100% provision
- Look at repayment history in last 3-6 months.
 - If meeting agreed repayments then consider move up one Res49 category.
 - If meeting agreed repayments and paying off arrears consider leaving at current Res49.
 - If no repayments leave at 100%
 - If frequent repayments but below agreed amount then treat as a rescheduled (for LBR purposes) and apply additional provision
 - If sporadic repayments, extrapolate over 12 months, identify what Res49 category they will be in and move to that category now. In most cases will require 100%
- This is all very judgmental and is not a hard and fast rule. Correspondences with Credit Control may lead to different conclusion on a particular account.

Provisioning – other considerations

- The ability of the member to make future repayments, in conjunction with their previous repayment history and character, is taken into account in determining the adequacy of the bad debt provision. Overall, the estimation of the recommended level of provision is based particularly on the following factors:
 - The adequacy of the members' past repayments in respect of their contractual obligations
 - Assessment of the current financial situation of the member through discussions with credit control staff and management to determine whether they have the ability to meet their contractual obligations in future periods
 - The level of confidence of the Credit Union's management in the integrity of the member and in the security of their current employment, where applicable.
 - Previous efforts made by the credit control staff, officers and collection agents employed by the credit union in respect of the member's account

Risk Provisioning (general)

- The impact of the Personal Insolvency Act 2012 may have a disproportionate impact on Credit Unions.
- Industrial Credit Unions
- Bad Debt Reserve

Other matters

- S35 Compliance
 - **Any amendment, alteration or change to a loan to avoid making bad debt provisions shall be considered a breach of these requirements and may result in regulatory action.**
- Compliance with any imposed restrictions
- Review of lending and credit control procedures
- Compliance with CU Act in relation to loan interest income measurement and disclosure
- Assessment of the underlying performance and future forecasted performance of the loan book

Reporting

Summary Findings

In accordance with our letter of engagement dated XX XXXXXX 201X we were requested by XXXXXXXX Credit Union Limited to assess the adequacy of the credit union’s existing bad debt provision for bad and doubtful debts in respect of the loan book at 30 September 201X. The terms of reference for this independent assessment were stipulated by the Central Bank in their correspondence forwarded to the credit union offices on XX XXXXX 201X. The original level of provision as at 30 September 201X, as prepared by the credit union for inclusion in the financial statements was assessed and additional levels recommended for agreement by the board where deemed appropriate.

The review criteria are detailed in full under the section headed “Methodology of Examination”

This independent loan book review has identified the need for additional bad debt provisions to be considered by the board for inclusion in the credit union financial statements as set out below:-

Summary of Bad and Doubtful Debts Calculation for 30 September 201X

	€	
Resolution 49 report bad debt provision balance as at 30 September 201X		(Appendix 3)
Additional override provision as provided by client as at 30 September 201X	_____	(Appendix 3)
Specific Bad Debt Provision as per management accounts to 30 September 201X		
Additional provision, for consideration by the credit union identified from review of loan portfolio as detailed above	_____	(Appendix 1)

Important

- If Credit Union are asked to have a loan book review – do not set AGM.
- Auditor should be informed at the earliest opportunity

FINALLY

- We are not always right – Always discuss with Credit Union first.
- Logical, structured and well thought out reasons for provisioning usually avoids queries
- The information is gained from our experience carrying out audit work, loan book review work and from reviewing Credit Union loan book reviews

Omnipro - Credit Union Conference 2013

PRISM Visits
17 September 2013

PRISM Overview

- Probability Risk and Impact System (PRISM) is the Central Bank's risk-based framework for the supervision of regulated firms.
- The principal is to apply a risk weighting to each regulated financial institution based on its potential impact on the financial stability of the overall economy.
- The intention is that it will be applied consistently across all regulated entities and provide clarity as to the opinions and views of the Central Bank.

PRISM Visits

- PRISM visits range from a general overview comprising one day of meetings with credit union officers up to a five day assignment which includes reviews of assets, policies and procedures as well as meetings with the officers.
- The topics covered at meetings include the following areas:
 - Current financial performance
 - Board skill-set and competences
 - Strategic planning and future direction
 - Strengths and weaknesses
 - Contingency planning

PRISM Visits (continued)

- Areas covered in auditor discussions:
 - Audit team make-up and timeline of engagement
 - Audit materiality and the basis for same
 - Specific risk areas identified in the audit plan
 - Non-audit services
 - Audit management letters
 - Opinion on the quality and experience of the board of directors
 - Opinion on the manager and the credit union's operation
 - Credit Union strengths and weaknesses

PRISM – Risk Mitigation Plan

- On completion of each PRISM assignment, the Central Bank will issue a “Risk Mitigation Plan” outlining the issues identified and the timeline for their correction.
- Each credit union will also be assigned a risk weighting which will impact on the number of supervisors attached to the credit union and also the frequency of future visits.
- Central Bank representatives have noted that follow-up visits will initially focus on the actions of the credit union to the matters highlighted in the Risk Mitigation Plan.

PRISM – Key Matters Noted

- The following are a sample of issues identified by Central Bank officials during the PRISM process:
 - Inadequate understanding or documentation of the credit union’s roadmap
 - Lack of documentation of assumptions underpinning financial projections and potential impact on value in use calculations and property impairment
 - No evidence of nomination committee consideration of expertise required on the board of directors or the impact of the fitness and probity regime
 - Inadequate succession planning
 - Lack of evidence of discussions with respect to disaster planning
 - Board of directors placing “too much” focus on operational rather than strategic matters
 - Lack of a policy register and evidence of periodic review of policies
 - Inadequate documentation of loan under-writing procedures

PRISM – Conclusion

- Requirement for a comprehensive strategic plan based on detailed financial projections to manage risk
- Financial projections to be prepared based on documented assumptions which are subject to stress testing
- Strategic plan to include consideration of external matters which if / when they were to occur would impact on the credit union's operation
- Documented organisation structure and succession planning
- Board of directors to review profile of membership and select suitable candidates for potential appointment as directors and office-holders
- Documented AML procedures to be put in place with defined officer roles

Contact details

E: David McArdle
david.mcardle@fmb.ie

Patrick Loughnane
patrick.loughnane@fmb.ie

W: www.fmb.ie

P: 01-6452002
Longboat
56 Sir John Rogersons Quay
Dublin 2

