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Credit Union Chair
By e-mail

7 September 2021

Re: 2021 Financial Year-End

Dear Chair,

This circular sets out our supervisory expectations in respect of the 2021 financial year-end process including some observations on the current economic environment and outlook and how this should inform credit unions' approach to the process. The circular also sets out specific expectations in relation to: (1) credit union investments; (2) impairment reviews; (3) credit union distributions and prudent reserve management; (4) systems of control; (5) accrued interest-contingent liability; (6) draft financial statements; (7) convening of AGMs; and (8) statutory notifications to the Central Bank. As we do each year, we are re-iterating a number of expectations that remain relevant to the year-end process.

Economic environment and outlook

As credit unions approach the 2021 year-end, the environment for credit unions remains challenging and the outlook uncertain. The Central Bank's Q3 Quarterly Bulletin[1] highlights the more favourable near-to-medium term prospects for the economy reflecting the impact of the progress of the vaccination programme and the relaxation of COVID-19 restrictions. However, as highlighted in the Central Bank's June Financial Stability Review[2], while the expansion of vaccination programmes has reduced uncertainty and downside risks to the macro-financial outlook, the recovery is likely to be uneven across countries and sectors and could be vulnerable to setbacks. Vulnerabilities in global financial markets have been building, amid higher levels of sovereign and corporate indebtedness. Looking beyond the pandemic, structural risks remain, including those stemming from changes in the banking sector, international tax changes and climate change. Credit unions need to give consideration to all of these factors as they seek to address the well-documented sustainability challenges many individual credit unions face.

[1] https://www.centralbank.ie/docs/default-source/publications/quarterly-bulletins/qb-archive/2021/quarterly-bulletin---q3-2021.pdf?sfvrsn=12
[2] https://www.centralbank.ie/docs/default-source/publications/financial-stability-review/financial-stability/financial-stability-review-2021-i.pdf

Accordingly, for all credit union boards a key aspect of the 2021 year-end process should be an informed identification and consideration of key risks and appropriate mitigation of such risks. It remains fundamentally important that a prudent approach is maintained to all aspects of a credit union's business to underpin the overall financial resilience of the credit union.

1. Credit union investments

With savings inflows continuing to outpace the demand for lending it is important that credit unions continue to maintain a prudent approach to investments. Credit unions are required to ensure that any investments they make do not involve undue risk to members' savings and should ensure that detailed analysis and careful consideration is undertaken before making any investment decisions to ensure associated risks are fully understood and considered.

We have become aware of some credit unions holding significant amounts in bank drafts. Bank drafts are not a permitted class of investment under the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 (the 2016 Regulations). It is the Central Bank's expectation that, as part of the management of operational risk and bank and cash control frameworks, credit unions should only hold funds in cash to the extent that this is wholly necessary for the day-to-day operation of the credit union.

2. Impairment reviews

(i) Loan Provisioning

Credit unions are reminded that overall responsibility rests with the board to ensure the adequacy and accuracy of the provisioning figure in the financial statements. Provisioning Guidelines, issued in April 2018, should continue to be used to inform the credit union's approach to assessing the level of required loan provisioning on an ongoing basis including for the 2021 financial year-end process. Boards should adopt a conservative approach to the measurement and recognition of loan provisions. It is expected that for 2021 year-end, consideration of the impacts of COVID-19 on loan books will continue to be a critical aspect of this work.

At this stage, based on the data submitted by credit unions, the vast majority of credit union borrowers who availed of payment breaks provided by their credit union have now returned to regular repayments. However, it is important that credit unions continue to engage with those members who are unable to return to making payments in line with the original terms of their loan to ensure that: (1) the most appropriate and sustainable solutions are put in place for them tailored to their circumstances; and (2) there is adequate provisioning for such loans.

Financial Reporting Standards

From a financial reporting aspect, Financial Reporting Standard 102 (FRS102) requires that, at the end of each reporting period, credit unions assess loans for objective evidence of impairment and that provisions should be immediately recognised. Credit unions should assess all loans for objective evidence of impairment based on all available information including current information and events at the date of assessment. Credit unions should consider how circumstances arising from the evolving economic situation may affect the likelihood of loss events occurring in their loan portfolios.

In summary, we expect that during the 2021 year-end process, as we would each year, that credit unions will undertake a detailed assessment of their loan books and identify appropriate loan loss provisions based on all available information at assessment. Credit unions must ensure that the approach is rigorous and prudent in seeking to identify and deal with distress within loan books - with an overriding objective of endeavouring to ensure, as far as possible, that the level of distress is not underestimated.

(ii) Review of fixed assets valuations

Where a *value in use* approach is adopted for the valuation of credit union premises, boards should consider the appropriateness of the underlying assumptions used in deriving the expected cash flows to ensure they are reasonable and supportable. The *value in use* calculation should be supported by realistic assumptions aligned with financial projections derived from achievable and realistic business objectives, taking account of changes to the economic and business environment.

(iii) Review of investments valuations

The review of investment valuations is another critical part of the year-end process. The accounting policy adopted by the credit union board for the valuation of investments should comply with the relevant sections of the Credit Union Act, 1997 (the 1997 Act), in particular section 110 and the relevant accounting standard. Section 110 of the 1997 Act requires that any item in the accounts shall be determined on a prudent basis and in particular that all liabilities and losses which have arisen, or are likely to arise in the financial year to which the accounts relate, or a previous financial year, shall be taken into account, including those liabilities and losses which only become apparent between the balance sheet date and the date the accounts are signed. Full and detailed disclosure of the accounting policy adopted for valuation of investments should be included in the annual accounts.

(iv) Multi-employer defined benefit plans

As you will be aware, the Financial Reporting Council introduced an amendment to section 28 '*Employee Benefits*' of FRS 102 in May 2019 which is applicable to accounting periods beginning on or after 1 January 2020, with early application permitted.

The amendment deals with transitioning from defined contribution accounting to defined benefit accounting for multi-employer defined benefit plans. The transition is required where sufficient information about the multi-employer defined benefit plan becomes available for the employer to apply defined benefit accounting for the first time. The amendments do not affect the requirement

to recognise the relevant liability or asset in relation to the plan. Credit unions who participate in a multi-employer defined benefit pension scheme should consider the implications this amendment may have for their 2021 financial accounts. Further information on this amendment to FRS 102 is available on the Financial Reporting Council's website at the link below.
https://www.frc.org.uk/news/may-2019/amendments-to-frs-102

Credit union boards should be mindful of their obligations under section 108 of the 1997 Act to ensure that the accounting records of the credit union give a true and fair view of the state of affairs of the credit union and disclose the financial position of the credit union.

3. Credit Union distributions and prudent reserve management

In the context of the 2021 year-end, credit union boards must be cognisant of the continued level of uncertainty on the economic outlook. Maintaining and building adequate levels of reserves, including adequate operational risk reserves, remains key to ensuring credit union financial stability and resilience.

Given the continued level of risk and uncertainty regarding the economic outlook, the Registry of Credit Unions expects all credit unions to continue to take a prudent approach to distributions in the context of reserve management. Where a credit union may be considering the potential for a proposed distribution, they are expected to contact their supervisor in the Registry of Credit Unions at an early stage to clearly outline the rationale for proposing this course of action, taking account of liquidity and operational resilience positions and the need to demonstrate prudent forward-looking capital reserve management in the current environment.

4. Systems of control and cybersecurity

Boards and management of credit unions are reminded of their responsibilities for establishing an effective internal control framework and for monitoring systems and controls on an ongoing basis. In assessing the systems of control, the board and management should ensure comprehensive policies and procedures are in place, proper accounting records are maintained and that effective segregation of duties and cash management processes are in place. The year-end process is an opportunity to review the internal controls environment and update as necessary.

Given the increasing number of IT and cybersecurity incidents reported by organisations both domestically and internationally, credit unions need to be *continuously* vigilant regarding the potential vulnerabilities in their IT systems. Given the potential adverse financial, legal, customer and reputational impacts arising from IT and cybersecurity incidents, identification and mitigation of risks in these areas remains a key focus for the Central Bank and should be a priority for all credit unions on an on-going basis.

Credit unions must ensure that they have strong and robust systems of controls in place to maintain ongoing compliance with section 76G(2)(a) of the 1997 Act (Information Systems). IT and Cybersecurity controls should be an integral part of the overall systems of control framework including in relation to data security and business continuity arrangements. It is the responsibility of credit unions to understand the range of specific IT related risks which they are exposed to and ensure that these are appropriately mitigated.

5. Accrued interest - contingent liability

It is important that credit unions ensure that appropriate recognition criteria and measurement bases are applied to contingent liabilities and that sufficient information is disclosed to enable members to understand the underlying matter.

A number of credit unions included a note in their financial statements for some or all of the years ended 30 September 2018, 30 September 2019 and 30 September 2020 referencing a contingent liability arising from the treatment of accrued interest in particular circumstances. It is our expectation that those credit unions will by now have taken the necessary steps to address the accrued interest matter that gave rise to the contingent liability noted in the prior years' financial statements.

As part of the 2021 year-end process we expect that, for those credit unions, all pertinent matters, including any decisions/actions taken during the year and, where relevant, any future planned actions are considered, in order to ensure that the financial accounts reflect an accurate position as at 30 September 2021. Specifically, it is expected that if a credit union has determined that any of its members have been affected by this matter, that those members have been advised/are being advised of planned actions/reimbursement as appropriate. Furthermore, it is expected that any update on the position of a credit union on this matter is provided to the membership by way of an updated note within the 2021 financial statements.

It is also expected that credit unions retain relevant records to support all decisions and actions which they have taken to address the accrued interest matter noted as a contingent liability in financial statements during the 3 year period from 2018 to 2020.

6. Draft financial statements

Credit unions are required to submit the Draft Financial Statements return in template format via the Online Reporting System (ONR) in advance of their finalisation as part of the 2021 year-end process. Where necessary, a credit union may also be required to submit the draft annual accounts in PDF format. Supervisors may follow up directly with individual credit unions on any issues arising as required taking account of the above.

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7. Convening of AGMs

At this stage substantially all credit unions have held a 2020 AGM with the vast majority of these held on a virtual/remote basis as provided for under amendments to the 1997 Act introduced in December 2020. In our circular of 25 February 2021, we recommended that credit unions pass a rule amendment at their 2020 AGM to ensure that they have the option to hold virtual general meetings beyond the interim period, which ended on 30 June. Accordingly, credit unions should be in a position to plan for their 2021 AGM, either through physical or remote/virtual AGMs, with the decision informed by COVID-19 public health measures in place at the time.

We have identified a number of issues during the process to register rule amendments passed at 2020 AGMs. As we move towards 2021 AGMs, it is a matter for individual credit unions to ensure compliance with their legal and regulatory obligations on an ongoing basis. Credit unions must satisfy themselves that the wording of all resolutions and rule amendments are correctly drafted, that they reflect the credit union's intentions and that they are aligned with relevant legislative provisions - before such resolutions and amendments are put to members at general meetings for approval, and are submitted to the Registry of Credit Unions for registration.

8. Statutory notifications to the Central Bank

For information, key statutory reporting dates/deadlines for the 2021 year-end process are attached at Appendix 1.

9. Conclusion

The Registry of Credit Unions expects boards and management of credit unions, in preparing their 2021 annual audited accounts, to take account of all of the matters set out in this year- end circular. In particular, boards need to carefully consider the adequacy of loan provisions, other asset impairments and prudent reserve management in 2021, given the current uncertain economic outlook and significant related challenges.

A copy of this circular will also be emailed to External Auditors of credit unions. If you have any questions on the foregoing, please contact your Supervisor in the Registry of Credit Unions directly.

Yours faithfully,

David Kielty
Deputy Registrar of Credit Unions

Appendix 1 – Statutory Notifications to the Central Bank

Pursuant to Sections 22 and 23 of the Central Bank (Supervision and Enforcement) Act 2013 credit unions are required to submit the following via the ONR:

- **Draft Financial Statements** to be submitted prior to setting a date for the AGM;
- **AGM Notification** minimum of 7 and maximum of 21 days before the AGM;
- **Final Financial Statements** by 31 March 2022;
- **Annual Audited Accounts** by 31 March 2022;
- **Annual Return** by 31 March 2022;
- **Change of Auditor**: in accordance with Section 117 of the Credit Union Act, 1997, a resolution at an AGM to change the auditor shall not be effective unless prior notice of the resolution has been provided to the credit union and the Central Bank not less than 28 days before the AGM;
- **Annual Compliance Statement**: in accordance with Section 66C of the Credit Union Act, 1997, credit unions are required to submit an Annual Compliance Statement by 30 November 2021.