

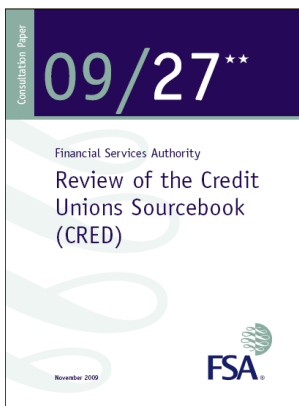


CREDIT UNION TECHNICAL UPDATE

WINTER 2009

ALEXANDER SLOAN, CHARTERED ACCOUNTANTS

CRED CONSULTATION



The FSA issued their consultation paper on proposed changes to the Credit Union Sourcebook (CRED) on 11 November 2009. The consultation paper introduces a number of changes to the rules governing Credit Unions. The FSA have stated that the changes are for two main reasons:

1. To update regulation in line with the proposed Legislative Reform Order (LRO); and
2. To increase the prudential standards.

The changes will have a large impact on all Credit Unions and it is therefore important that Credit Union Directors review the paper for what it means to their Credit Union. The consultation process on the Sourcebook is open until 10 February 2010.

The proposed changes within the consultation include:

Accounting Deadline

The deadline for the submission of the Accounts and Annual Return deadline will reduce from 7 months to 4 months following the year-end. This change is expected to come into force for many Credit Unions for their 30 September 2010 accounts. Credit Unions will need to review their reporting systems to ensure that they are in a position to meet this new deadlines.

We would like to assure our clients that we will be able to provide them with external audit services within this timescale.

Capital

- An increase in the minimum initial capital for a new Credit Union from £1,000 to £10,000 for a Version 1 Credit Union and from £5,000 to £50,000 for a Version 2 Credit Union.
- A transitional limit will be introduced requiring a Version 1 Credit Union to have a capital-to-asset ratio of at least 1.5% from 30 September 2011.
- An increase in the minimum capital-to-asset ratio for a Version 1 Credit Union from the transitional rate of 1.5% to 3% from 30 September 2012.

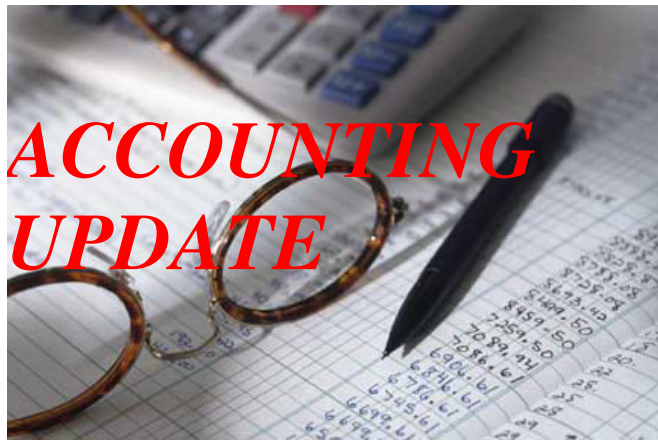
Liquidity

- A transitional limit will be introduced requiring all Credit Unions to have a minimum liquidity ratio of 7.5% from 30 September 2011. Version 1 Credit Unions will also not be allowed to have a liquidity ratio below 10% in two consecutive quarters.
- An increase in the minimum liquidity ratio for all Credit Unions to 10% from 30 September 2012.

Other Changes

Some of the other changes include:

- Clarification of how attached and unattached shares as well as deferred shares effect the prudential requirements within CRED.
 - CRED will be changed to CREDS with changes to the content.
 - New Credit Union Regulatory Guide to be issued (CURGS).
 - Additional guidance on bad debt provisions.
- Please see our website for a link to the consultation document to see the full list of changes.



Accounting changes have been announced that could have a significant impact on Credit Unions. The Accounting Standards Board (ASB) has issued a consultation paper on the future of UK Generally Accepted Accounting Principles (GAAP). This paper sets out proposals for the accounting rules that would apply to different types of entities within the UK.

Under the proposals there would be three tiers:

- **Tier 1-** Publicly accountable bodies who would have to prepare accounts under EU adopted International Financial Reporting Standards (IFRS).
- **Tier 2-** entities not covered by tiers 1 or 3 would prepare accounts under the new standard IFRS for SMEs (Small and medium sized entities).
- **Tier 3-** small entities would prepare accounts under the Financial Reporting Standard for Smaller Entities.

Entities within a lower tier could choose to adopt the accounting requirements of a higher tier. Entities would not be allowed to adopt the accounting rules of a lower tier.

The ASB hopes to introduce the new regime from 2012.

Under the current proposals, all Credit Unions would be classed within Tier 1. The conversion to full International Accounting Standards can be a complicated, costly and time consuming process. The impact on Credit Unions is therefore likely to be significant.

Under the proposals, large companies, such as Virgin and Thames Water despite their size would however, be in Tier 2 and therefore be subject to less complex accounting requirements.

The reason Credit Unions have been included within Tier 1 is that the ASB argue that they are 'publicly accountable'. It can, however, be argued that Credit Unions hold funds of members and are only accountable to them as opposed to the public.

The publicly accountable definition is designed to ensure banks and building societies are caught by the requirements. These bodies are not as restricted in their activities as Credit Unions and therefore there is less reason for Credit Unions to have to meet the same level of accounting requirements.

The ASB is considering charities and housing associations separately arguing that they are public benefit entities. It is considering a number of options for these bodies including a separate accounting standard specifically for public benefit entities. The ASB has stated that it is aware of the cost implications for public benefit bodies having to comply with full IFRS. Credit Unions, despite their obvious public benefit, have been excluded from this category.

We would therefore encourage Credit Unions to take part in the consultation to ensure that Credit Unions' views are taken into account in the process which will have such an impact on their accounts. The consultation process is open until 1 February 2010. A link to the document is included on our website at www.alexandersloan.co.uk/credit.htm.

FSCS LEVY UPDATE

Invoices for the FSCS levy for 2008/09 were issued by the FSA earlier this year. The FSCS had to borrow funds to cover the recent high profile banking collapses. For the first 3 years, the FSCS only repays interest on these borrowings. Levies for deposit takers, including Credit Unions, in this period are used towards the interest and management expenses incurred by the FSCS. After the initial three year period, the FSCS will have to repay any capital which has not been recovered. Therefore, after the initial period, there may be additional payments due by Credit Unions into the FSCS to cover these costs. The level of these payments will depend on what the scheme receives back from the collapsed banks in the meantime. The FSA is pursuing the failed banks and it is hoped that they will recover much of the principal amount borrowed. ABCUL have issued a guidance note to their members which provides further information.

REGULATOR'S FOCUS ON BUSINESS PLANS

Business Plans are the latest issue to come under the FSA spotlight. The latest issue of the FSA's Credit Union newsletter focuses on Business Plans and is accompanied by guidance notes on this issue. Links to both the newsletter and the accompanying notes can be found on our website.

Some hints and tips when creating Business Plans are as follows:

- **Objectives-** The plan should be based on the Credit Union's objectives and should be a tool to help the Credit Union achieve its aims. It should highlight the activities that the Credit Union intends to undertake in order to meet its objectives and set targets.
- **Be Realistic-** A good business plan should consider the threats the Credit Union is facing and not be over-optimistic about future events. The main purpose of the plan is as a management tool and a plan that hides problems will cause more problems than it solves.
- **Up to Date-** The plan needs to be up to date in order for it to be useful. Basing decisions on out of date projections may lead to the wrong decisions being taken. It is therefore important that your plan is regularly reviewed and updated once it has been created.
- **Relationships between figures-** The different parts of the plan should interlink. Increases in share and loan balances will increase LP/LS insurance, likewise, large increases in the operations or size of the Credit Union will normally have an impact on staff levels and costs. For the plan to produce meaningful results, it needs to take into account these relationships.
- **Review-** It is important that the plan and projections are reviewed by someone who understands them before they are finalised. All projections are based on assumptions and it is therefore important that they are not based on just one person's opinion of what will happen.
- **Sensitivity Analysis-** Sensitivity Analysis and Stress Testing can provide useful information to the Board. These tools look at what will happen to the projected results if key assumptions change. For example, sensitivity analysis can be used to see what will happen to your business if the level of bad debts changes. This can help to show how exposed your Credit Union is to changes and help you plan for adverse events.
- **Early Warning-** Business Plans can be set up to provide projected FSA capital to asset ratios. This can be used to help identify in advance if you are likely to fail to comply with FSA requirements giving you a pre-warning and a chance to rectify the situation. There are currently a number of proposed changes to the Prudential Standards within CRED. Your Business Plan can be set up to show if your Credit Union can meet these requirements and highlight any planning issues.
- **Presentation of Information-** Financial projections are often not understood by non-accountants. The financial projection should use graphs and tables to highlight key figures and trends to members of the Board and allow them to focus on the key parts of the plan.

ALEXANDER SLOAN BUSINESS PLAN

Complies with FSA guidance	<input checked="" type="checkbox"/>
Useful Management tool	<input checked="" type="checkbox"/>
Projection model that understands Credit Union's business	<input checked="" type="checkbox"/>
Includes Sensitivity Analysis	<input checked="" type="checkbox"/>
Provides easy to understand Graphs & charts of key ratios	<input checked="" type="checkbox"/>

At Alexander Sloan, we have experience of creating Credit Union Business Plans which meet the FSA requirements. The Business Plan is tailored to meet Credit Union specific requirements and uses our in house developed Credit Union model. If you require help or assistance in setting up your Credit Union's Business Plan then please contact Steven Cunningham at creditunion@alexandersloan.co.uk or at (0141) 204 8984.



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ABOUT ALEXANDER SLOAN

We are authorised by The Institute of Chartered Accountants of Scotland to carry on audit work. We have offices in Glasgow and Edinburgh and provide external audit services for a range of both employment and community based Credit Unions. We also provide internal audit services for a number of not for profit organisations.

Our Credit Union services include:

- External Audit
- Internal Audit
- System advice/internal audit for banking services
- Developing internal audit programmes for use by the Supervisory Committee
- Training for Board and Committee Members
- Annual Return Completion
- Business Plans

We offer a “no fee” introduction meeting for prospective clients before we provide a quote so we can properly assess your requirements.



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