2023, Issue 1

The Auditor's Report

Employee Retention Credit

The Employee Retention Credit (ERC) is a refundable tax credit designed for businesses that continued paying employees while shut down due to the COVID-19 pandemic or who had significant declines in gross receipts from March 13, 2020, to December 31, 2021. Eligible taxpayers can claim the ERC on an original or amended employment tax return for a period within those dates.

To be eligible for the ERC, employers must have:

- sustained a full or partial suspension of operations due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19 during 2020 or the first three quarters of 2021,
- experienced a significant decline in gross receipts during 2020 or a decline in gross receipts during the first three quarters of 2021, or
- qualified as a recovery startup business for the third or fourth quarters of 2021.

What is an uncertain tax position under U.S. GAAP?
Because this new tax rule has not been subject to prior Internal Revenue Service (IRS) audits, this tax position may be considered "uncertain" within the application of generally accepted accounting principles (GAAP). Before discussing accounting for an uncertain tax position, let's discuss tax law.

Tax law is subject to interpretation, and it may be uncertain as to whether a tax position taken by a credit union will be sustained upon review. This uncertainty leads to questions about whether tax positions taken or to be taken on tax returns should be reflected in the financial statements before there is a final resolution with the tax authorities.

Accounting Standards Codification (ASC) Section 740-10-25 defines the threshold for recognizing the benefits of tax return positions in the financial statements as "more likely than not" to be sustained by the tax authority based solely on its technical merits as of the reporting date. In making this assessment, a company must assume that the tax authorities will examine the position and have full knowledge of all relevant information. In other words, detection risk is not considered in the assessment.

An evaluation of the tax position must be performed to determine whether it is more likely than not (greater than a 50% chance) that the taxing authority would sustain the position solely on its technical merits.

If a tax position is not considered more likely than not to be sustained solely on its technical merits, no benefits of the position are to be recognized in the financial statements. If a tax position meets the "more-likely-than-not" threshold, it should be measured based on the largest benefit that is more than 50% likely to be realized.

Recognition test
The recognition test assumes that the tax authority will examine the uncertain tax position and has full knowledge of all relevant facts. No consideration is given to offsetting or aggregating tax positions in negotiations with the tax authority.

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Importance of Reviewing System and Organization Controls (SOC) Reports

Credit unions are increasingly outsourcing services and technology. However, risk is never completely outsourced. Thus, it is becoming increasingly important to understand the controls at the service organization and any compensating controls the user entity must put in place to decrease risk. An effective due diligence review of a service organization would include a review of SOC reports.

SOC reports are governed by the American Institute of Certified Public Accountants (AICPA) and focus on offering assurance that the controls service organizations put in place to protect their clients' assets (data in most cases) are effective. There are four main types of SOC reports.

a. SOC 1: Focuses on outsourced services performed by service organizations that are relevant to a credit union's (user entity) financial reporting.

b. SOC 2: Focus addresses operational risks of outsourcing to third parties outside financial reporting. These reports are based on the Trust Services Criteria which include up to five categories: security, availability, processing integrity, confidentiality, and/or privacy.

c. SOC 3: Is not as comprehensive as a SOC 2. It excludes certain details of the description and all the detailed controls/results of testing. It is a general use report, primarily used for marketing purposes.

d. SOC for Cybersecurity: A CPA reports on an organization's enterprise-wide cybersecurity risk management program.

In some cases, a vendor may have more than one type of SOC report completed and/or carve out their subservicers. In this case, a credit union should review all reports available for their vendor and any subservicer used that apply to their environment.

Each SOC report will have an independent auditor's opinion about the description of the service organization's system and whether it is presented fairly and whether the controls in the service organization are suitably designed to ensure the security of the user entity. If the opinion given is anything other than an unmodified opinion, the credit union should evaluate the impact of the qualifications on their controls and how they may affect their data and systems.

The SOC reports may have exceptions or points of non-compliance. A credit union should review these and determine the impact, if any, on their data and systems.

All service organizations have weaknesses the credit union must address. These weaknesses can be resolved by putting in compensating controls which are referred to as Complementary User Entity Controls (CUEC). CUECs are controls that a credit union must implement to ensure the vendor's controls are effective. If a credit union does not address these controls, it puts the credit union at greater risk for not having proper controls in effect.

Controls at a credit union are important to protect the integrity of the data and the security of member information. Regulators are increasing the scrutiny of a credit union's due diligence on third-party vendors that process data for the credit union. This scrutiny includes initial due diligence and ongoing monitoring. Reviewing SOC reports is a critical piece of this due diligence both at the initial selection of the vendor and ongoing monitoring.

By completing a comprehensive review of the SOC reports, the credit union will have a better understanding of the vendor's overall risk profile and be able to adjust their controls at the credit union to compensate for any weaknesses.

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ABOUT US

Since 1979, Nearman, Maynard, Vallez, CPAs has provided auditing and consulting services exclusively to credit unions throughout the United States. Our dedication to the credit union industry has given us the unique ability to provide exceptional service at a reasonable price. Our primary objective is to assist our clients in accomplishing their goals through our experience, service, and commitment. If your Supervisory/Audit Committee, Management, or Board of Directors is interested in obtaining information on the subjects in this issue or about our many services, call or email us today.

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In evaluating the technical merits of a particular tax position, a credit union may only consider past examination activity to the extent that the taxing authority explicitly agreed to the item. If the recognition test is not satisfied, the credit union cannot recognize a benefit for the uncertain tax position.

It is the position of Nearman, Maynard, Vallez CPAs, and other audit firms working in the credit union industry, that the ERC can be an uncertain tax position in some cases. Generally, ERC filings based on a significant decline in gross receipts are not subjective and should be somewhat easy to support. However, ERC filings based on a shutdown are more subjective and therefore fall under the uncertain tax position. When monies are received related to an uncertain tax position they should be recorded as deferred revenue until either the credit union is audited by the IRS or the period subject to IRS audit has passed.

Should you wish to discuss this matter with someone from Nearman, Maynard, Vallez CPAs please contact one of the firm's Partners at your convenience.

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NCUA Issues 2023 Supervisory Priorities

Earlier this year, NCUA published a letter outlining their 2023 supervisory priorities along with updates to their examination program. NCUA will focus on the risks to the credit union industry and their members as well as the National Credit Union Share Insurance Fund (Share Insurance Fund).

The primary areas of supervisory focus in 2023 are as follows:

- Interest Rate Risk
- Liquidity Risk
- Credit Risk
- Fraud Prevention and Detection
- Information Security (Cybersecurity)
- Consumer Financial Protection
- Other Examination Updates
    - Current Expected Credit Loss Implementation
    - Succession Planning
    - Support for Small Credit Unions and Minority Depository Institutions
    - Post-Examination Survey

Click the following link to read more details so you can be prepared for your audit in 2023.

https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/ncuas-2023-supervisory-priorities

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