



Examination Process – General Ledger Review

October 29, 2002

The review of a credit union's general ledger and its related subsidiary ledgers is a key area of the examination and should give the examiner a clear impression of the credit union's financial position and its relative financial stability.

Objective of the General Ledger Review – The purpose of the general ledger review is to determine that:

- The credit union has adequate policies, practices, procedures, and internal controls regarding its assets, liabilities, and equity;
- Accounting personnel operate in conformance with established bylaws, rules and regulations, and accounting norms;
- Assets are properly recorded;
- Liabilities and equity are properly recognized and recorded on the books; and
- Credit union management initiates corrective action when made aware of deficiencies or violations in policies, practices, procedures, or internal controls.

Scope of General Ledger Review – Early in the exam process, examiners should review the reports of the internal and external auditors, and if necessary, the workpapers along with the prior examination report to assist them in determining the scope of the general ledger review.

When the previous examination or supervision contact discloses no material record keeping problems, interviews with management and staff disclose no internal control or other concerns, and examiners note no material concerns in the initial review of the books and records, the examiner can use a normal scope review. Additionally when the credit union has had an acceptable external audit, examiners may reduce the general ledger review to the complexity and risks involved.

Similarly, if initial examination procedures disclose major concerns examiners will expand the analysis of the general ledger to a point where they can determine the extent of the problem and develop effective plans for corrective action. The level of analysis depends upon the complexity of operations and the seriousness of adverse conditions.

At a minimum the accuracy, documentation, and timeliness of the accounting for the following accounts should be reviewed:

- ◆ Loans
- ◆ Provision for Loan Losses
- ◆ Accounts Receivable
- ◆ Cash
- ◆ Investments
- ◆ Material Fixed Assets
- ◆ Accrued Income

- ◆ Accrued Dividends Payable
- ◆ Suspense and Clearing Accounts
- ◆ Member Shares and Deposits
- ◆ Equity or Capital Accounts
- ◆ Any accounts with large monetary transactions
- ◆ Any accounts associated with new programs initiated since the last examination

Examination Procedures – When analyzing general ledger accounts, examiners should:

- Determine that the general ledger accounts and balances are supported by an independent subsidiary ledger;
- Determine that the account is in balance with the total of its subsidiary ledgers;
- Review the debits and credits to analyze any unusual activity; and
- Determine the propriety of entries in each account.

Verifying source documents (such as the member share and loan trial balance or the bank statement) or actual receipts is an effective method of reviewing general ledger accounts. Normally, an examiner does not audit or verify individual entries in either the subsidiary ledger or the general ledger account, this is the work of the internal and external auditors. The examiner normally does not attempt to balance subsidiary ledgers to their general ledger accounts. Instead, the examiner should determine why the account is out of balance or unreconciled and bring the problem to the attention of the credit union officials and management both verbally and in writing using the Examiner Findings document.

The examiner may choose to perform additional examination procedures when records are out of balance or internal controls are weak. The depth of each general ledger account will vary from one general ledger account to another. The most critical elements in determining the depth of the review are:

- Account materiality - with regard to the credit union asset size and effect of the account on the credit union's capital (if a potential loss exists) and profitability (e.g. if accrued income is overstated the effect on the balance sheet could be minor while the effect on the income statement and profitability material);
- Unusual activity - is that which is out of the ordinary such as a large amount of deposits to the bank account as compared to credit union asset size, or that which might adversely affect the credit union which could include clearing accounts that do not clear to zero timely or bank accounts that are not reconciled and/or reconciling items on the bank reconciliation that are not researched and corrected quickly; and
- Quality of the external audit.

General Ledger Review Process – The examiner who is performing the review of the general ledger should perform the following steps to ensure that the financial position of credit union is fairly stated:

1. Verify that the financial statements balance and are correct by calculating total assets, liabilities, and equity.

2. Verify that each one of the balances in the financial statement concurs with a balance in the general ledger.
3. Determine that all financial reports (such as a call report) submitted to the regulatory agency since the last examination are accurate.
4. Determine the subsidiary ledgers balance with the supporting account in the general ledger. The credit union should have a subsidiary ledger for each account in the general ledger and the accountant should balance the subsidiary ledgers with their respective general ledger account no less than monthly.
5. Review the bank reconcilements for the last two months to determine that:
 - The account and any other negotiable cash account is in balance between the credit union and the bank;
 - No checks have been outstanding for more than six months, all checks are written in sequential order, and that the checks have been signed by authorized personnel;
 - Blank checks are not signed in advance;
 - Deposits are made timely and deposits in transit from the previous bank reconciliation have cleared and are accounted for both on the credit union's and the bank's records;
 - All entries to the account both by the bank and the credit union are correct and have supporting documentation;
 - All canceled and voided checks have been accounted for properly;
 - There are no suspicious checks written to creditors, members, or others;
 - All checks have been written for authorized and reasonable expenses, member withdrawals, member loans, or investments and that they have been signed by authorized individuals only; and
 - Dual controls exist on all cash transactions and wire transactions.
6. Review the entries in the Provision for Loan Loss account to determine that the accounting is proper. To that end, the examiner should ensure that the charge off loans have been approved by the board of directors and are equal to the amount noted in the board minutes and there are no other entries to the account outside of the approved charged off loans, recoveries on charged off loans, and expense adjustments to increase or decrease the account.
7. Ensure that the amount of cash on hand or in possession of the Cashier is equal to the amount stated in the general ledger.
8. Compare the investment subsidiary ledger(s) (statements received from the firms holding the investments) and ensure that the balance on the ledger(s) is equal to the amount in the general ledger.
9. Determine the Accounts Receivable balance represents funds that are 100% collectable. If not, a reserve account should be established in the amount of the potential loss.

10. Verify that the Accrued Income accounts are accurately stated. Overstatement of these accounts can have a material effect on the income statement and credit union profitability.
11. Verify that the depreciation on all fixed assets is equal to the asset lives and is reasonable. Ensure the amortization of prepaid and deferred expenses is correct.
12. Determine if there are any suspense accounts, entries or amounts in the accounting records that can not be identified. If so, the age of the entry and amount should be documented. If the unidentified entry can not be resolved during the examination and it is a potential loss, it should be reserved for or written off.
13. Ensure all entries to clearing accounts are cleared from the account in a timely fashion. Items in clearing accounts that do not clear timely are indications of accounting problems.
14. Determine if the credit union has any material contingent liabilities that could effect profitability and if they have been accounted for correctly.
15. Assess the correctness of the Accounts Payable. The account balance should represent amounts due and payable within the next 30 days.
16. Verify that the accrued dividends payable on member deposits is accurate. If this amount is understated, the effect is an overstatement of net income.
17. Determine that the amounts of member loans and shares are equal to the amount on the general ledger.
18. Ensure that the board of directors has approved all of the entries in the equity accounts and that they are in compliance with credit union law and regulatory guidelines.
19. Verify the correctness of all other accounts that are material as compared to total assets.

Signs of Warning – These signs or indicators are ratios, numbers, trends, or suspicious activity that may indicate existing or potential problems. During the review of the general ledger and the financial statements, the examiner should look for the following signs of warning:

- Continual account problems;
- Bank reconcilements that are incomplete, in arrears and/or out of balance;
- Frequent bank account overdrafts;
- Cashier(s) is out of balance between his/her record's and the general ledger,
- Lack of due control over cash transactions;
- Numerous corrections to accounting records;

- Numerous voided checks and checks written to persons or entities with no connections to the credit union;
- Large number of outstanding checks;
- Deposits in transit that do not clear within 1 to 2 days;
- Checks written out of sequential order;
- Bank account deposits that are made outside of established procedures;
- Lack of a clear audit trail in the accounting records;
- No subsidiary ledgers, subsidiary ledgers that are not current and/or out of balance;
- Clearing and/or suspense accounts that do not clear to zero in a timely fashion;
- Overstated accrued income, understated accrued dividends, depreciation of fixed assets, or amortization of prepaid expenses greater than their useful lives;
- Unauthorized entries to the Provision for Loan Loss account or any of the equity accounts;
- Incorrect use of accounting forms or using accounting forms that have not been designed for the specific purpose in which they are being used; and
- Account activity that is in excess of the normal amount of transactions for the operational needs of the credit union.

Examination Workpapers – Workpapers are the written documents prepared or obtained by the examiner while performing an examination. The workpapers serve as the basis of the work performed and support the results of the examination and the opinions of the examiner. They should provide sufficient information so that the reviewer does not have to obtain any additional information from the credit union to support the conclusions, once the examination has been completed. General ledger workpapers should consist of the financial statements, the general ledger balances, copies of the subsidiary ledger balances and all examiner developed workpapers used to support and/or clarify the work performed. The workpapers should clearly state the scope and objective of the review, the account being reviewed, the date of the examination, who performed the work and the date, the general ledger balance, the subsidiary ledger balance, any differences between the balances, and appropriate notes and explanations.

An easily understandable index system should be used to organize the general ledger workpapers. All workpapers should be maintained within the regulatory agency, in a safe place, along with the final report. They should be available for review and used at the next examination.

General Ledger Deficiencies – Any problems that can not be resolved during the exam should be noted in the final report in the “Examiner Findings”. This document lists operating exceptions, violations of law or regulation, unsafe and unsound policies, practices and procedures. Relatively minor or infrequent infractions should not be discussed within this document; because they distract from the more important matters. Immaterial issues should be discussed orally with the manager or appropriate employee.

When identifying a finding, the examiner should include a precise description of the problem or violation, who is responsible for correcting the problem, the specific section of the Law, bylaws, rules and regulations or other authority which the finding violates. In

the event that the credit union violates more than one of the aforementioned, the examiner should cite the highest authority. Examiners should also include on this document exceptions that were noted at previous exams that have yet to be corrected. These findings should be cited under a heading of a similar nature.

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