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Analysis of the AICPA's required reclassification of the shareholders' equity to liabilities in the balance sheets of credit unions

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ANALYSIS OF THE AICPA'S REQUIRED RECLASSIFICATION
OF THE SHAREHOLDERS' EQUITY TO LIABILITIES
IN THE BALANCE SHEETS OF CREDIT UNIONS

By

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INTRODUCTION

Statement of Topic

Traditionally credit union members' shares or account balances have been classified as shareholders' equity in the balance sheets of credit unions. In May, 1986, the American Institute of Certified Public Accountants (AICPA) issued a new audit guide to be used by certified public accountants (CPAs) in the audits of credit unions' financial statements issued after December, 1986. This guide requires that members' account balances now be presented as liabilities rather than as equity and dividends must be presented as interest expense in order for a CPA to issue an unqualified opinion on the financial statements. The reclassification has been a controversial issue resulting in a lawsuit being filed in district court in Madison, Wisconsin by Credit Union National Association, Inc. (CUNA) and Navy Federal Credit Union against the AICPA.

This paper proposes to analyze the reclassification decision and the potential impact on credit unions. The paper will review the history of credit union shares, present the reasons cited by the AICPA in support of reclassification, discuss the credit union concerns and the lawsuit against the AICPA, and present examples of financial statements issued by a credit union, a mutual savings and loan association, and a bank. The credit union's statement will be restated to show the result of reclassification. The final chapter will consist of a discussion of the issues and the potential implications for credit unions.

Background Information

The AICPA is a national non-profit corporation. It is recognized as the professional organization for certified public accountants in the United States. The AICPA's primary purpose is to produce generally accepted auditing standards (GAAS) as guidelines for CPAs when auditing financial statements. Audit guides are published for various industries with problems requiring special treatment. Even though CPAs are not required to become members of the AICPA, they are all expected to follow the standards created by the organization.

Generally accepted auditing standards stipulate that a CPA must use due professional care in conducting an audit and that the statements must conform to generally accepted accounting principles (GAAP). The AICPA doesn't establish GAAP. Instead the Financial Accounting Standards Board (FASB), who is independent of the AICPA, has the authority for issuing GAAP. The AICPA Codification of Statements on Auditing Standards defines GAAP in code section AU 411.02 as follows:

"technical accounting term which encompasses the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. It includes not only broad guidelines of general application, but also detailed practice and procedures."

The primary reason that a business would contract for an audit would be to receive an opinion concerning the fair presentation of its financial statements from an independent CPA. These opinions are required or expected by a variety of stakeholders such as lenders and stockholders. Ideally the organization would receive an unqualified (clean) opinion stating that the records have been prepared in accordance with GAAP.

CUNA is a non-stock corporation organized in 1934 with headquarters in Madison, Wisconsin. It is a national trade association representing the interests of credit unions and providing a wide variety of support services to individual credit unions and to state credit union leagues. The state credit union leagues provide information on numerous subjects such as professional training and legislation as well as promote cooperation within the credit union movement. Individual credit unions may become members of their state's league of credit unions. Membership is not required; however, 90% of federal and state-chartered credit unions are members of the state leagues.[1] CUNA's membership consists of the state leagues rather than individual credit unions.

Navy Federal Credit Union was granted a federal charter on June 12, 1947 in Vienna, Virginia and presently has $2,619,031,000 in assets with a membership of 778,695. Members total share accounts amount to $2,358,267,000 with reserve balances of $175,765,000.[2]

CUNA has opposed the reclassification since the original issuance of an exposure draft of a credit union audit guide in 1982. Exposure drafts are normally issued when the accounting profession proposes changes. The purpose of an exposure draft is to allow comments from interested parties in order to ensure that all aspects of the changes are considered. Since 1982, CUNA has filed formal opposition statements and appeared in opposition at hearings. CUNA had cited the AICPA's own statement that the reclassification is contrary to the historical treatment of credit union shares

[1]CUNA, History & Philosophy V01, Volunteer Achievement Program (Dubuque, Iowa: Kendall/Hunt Publishing Co.,1984).
[2]Stark, Bill, Virginia Credit Union League, Lynchburg, VA. Telephone interview, July 1, 1987.

as equity.[3] CUNA President Jim Williams was quoted as saying that the "AICPA strikes at the very heart of credit union structure, the member ownership principle." In addition, he stated that the change was contrary to the Federal law, philosophy of credit unions, and the best interests of the institutions' members.[4]

[3]AICPA, Audits of Credit Unions (New York, NY: AICPA,1986).
[4]"AICPA Suit Filed," News, Credit Union Magazine (November 1986), pp. 16-17.

CHAPTER II

HISTORY OF CREDIT UNION SHARES

Credit Union Ownership

A credit union is a cooperative owned and controlled by the individuals who use it. A true co-op can be identified by the following four characteristics: economic benefits accrue to its members; the organization is service oriented versus profit oriented; members who are the users control the organization; and the members share a common bond.[5] Per the Federal Credit Union Act requirements, the credit union membership must share a common bond such as employment at the same business or residency in a particular community. Nearly 80% of credit union members in 1984 were members of credit unions with occupational bonds.[6]

The credit union operates as a democracy where each member/owner is allowed only one vote regardless of his ownership interest. Member patrons control the direction of the credit union by electing directors from the membership.

[5] CUNA, History & Philosophy V01, Volunteer Achievement Program (Dubuque, Iowa: Kendall/Hunt Publishing Co.,1984), p.5.

[6] CUNA, History & Philosophy V01, Volunteer Achievement Program (Dubuque, Iowa: Kendall/Hunt Publishing Co.,1984), p.6

The directors serve on a volunteer basis only, which has historically served to help keep operating costs low. Profits earned are distributed to the members or retained in the business for the purpose of improving member services. Only the membership is allowed to use the services of the credit union.

Credit union shares are the members' savings deposits in the credit union. Federal credit unions must have a regular share account available to members, which only requires the maintenance of the par value of one share. Notice of intent to withdraw from this account cannot be required. The credit union has flexibility in establishing the par value of shares. Historically, par value has been considered to be $5. NCUA defines various types of shares accounts and share certificates but still allows individual credit unions the ability to select and establish numerous accounts which will satisfy the needs of its members. Some of the account types suggested are regular shares, share draft accounts, and share certificates.

As noted above, credit union shares have been classed as equity since a member is required to own one share to have access to membership privileges and in return is guaranteed one vote. For dividends to be paid in any business, the entity must have income or an unrestricted retained earnings balance, cash available, and formal declaration of the dividend by the board of directors. Credit union shares have these characteristics also. In addition, a credit union's capital consists primarily of members' shares. The remainder of equity is retained earnings generally substantially restricted due to regulatory requirements. The main account in this section is the regular reserve. The purpose of the regular reserve is to serve as a cushion for uncollectible loans. However, this is a bookkeeping entry only and not actual money set aside.

The regular reserve is required by NCUA to be increased by a prescribed percentage of gross income at the end of each accounting period. The regular reserve account balance may only be decreased if the current period's loan losses exceed the balance in the allowance for loan loss account.

By law, credit union shares create an ownership interest in the credit union. In contrast, a debtor-creditor relationship exists when individuals deposit in other financial institutions. The result is that a credit union shareholder's interest would be subordinate to the interest of the credit union's creditors. This may be important if there is a loss. However, the members' shares are protected by the National Credit Union Share Insurance Fund. All federal credit unions are required to carry this insurance and it is available to state chartered credit unions at their option. The Fund provides up to $100,000 per account with IRA accounts insured separately.

Federal Credit Union Act

The Federal Credit Union Act (FCU Act) was signed into law by President Roosevelt in 1934. Prior to this time, credit unions were allowed only in states who had passed their own legislation. Twelve states did not have the appropriate statutes. With the FCU Act, credit unions could be incorporated in any of the states. Credit unions are allowed to convert from federal to state charters or vice versa. Should a credit union change from a federal charter to a state charter, the provisions of the FCU Act would no longer apply. The state regulations would be followed instead.

The purpose of the FCU Act was to "establish a further market for securities of the United States and to make more available to people of small means a national system of cooperative credit, thereby helping to stabilize the credit structure of the United States."[7] Originally the responsibility for administration was placed under the Farm Credit Administration. The FCU Act has been revised at various times during the years to follow with major reforms

[7]NCUA, The Federal Credit Union Act (Washington, D.C.: NCUA, October 15, 1982) p.1.

in 1959 and 1977. Responsibility for administration has changed and new services have been made available to the credit union members due to these reforms.

The FCU Act defines a member account or account as being "a share, share certificate, or share draft account of a member of a credit union." (Section 1752) The initial par value of the share is required to be established at the time an application for organization certificate is submitted to the NCUA Board for approval. The certificate also must include the names and addresses of the subscribers and the initial number of shares subscribed. Membership consists of the incorporators as well as any individuals with the common bond who later subscribe to "at least one share of stock." This indicates that the law views members' savings as stockholders' equity.

National Credit Union Administration

Since 1970, the National Credit Union Administration (NCUA) has been the autonomous organization responsible for the operations of credit unions. NCUA is funded by annual operating fees from each credit union rather than through taxpayer's money.

The Accounting Manual for Federal Credit Unions is published by NCUA and is referred to in sections 701.2 and 701.14 of the NCUA Rules and Regulations. This incorporation gives the manual the force and effect of law.[8] If the manual does not provide direction for a specific accounting procedure, section 2030 instructs credit unions to obtain guidance from AICPA and FASB pronouncements. This section allows credit unions to follow any accounting profession pronouncements that do not conflict with required NCUA procedures. The AICPA Committee on Credit Unions may be contacted for guidance on specific issues providing NCUA has an opportunity to review the resulting recommendations.

The Accounting Manual for Federal Credit Unions requires that financial statements include "full and fair disclosure of all assets, liabilities, and members' equity." (Section 702.3(b)(1)). Financial statements are required as shown in the manual or may be individualized providing the information is in the same format. Four types of financial statements are normally used. The Statement of Financial Condition (i.e., balance sheet) and the Statement of Income are required on a monthly basis for internal credit union use, information for members, and NCUA reporting. The Statement of Changes in Equity must be prepared quarterly and, for those entities utilizing the accrual basis of accounting, the Statement of Changes in Financial Position is prepared annually. The Statement of Financial Condition

[8] Connell, Lawrence, NCUA, Washington, D.C., Letter to Board of Directors of Federal Credit Unions, September 16, 1981.

consists of three sections; assets, liabilities, and savings and equity (See Appendix A). The reports use the numbering system of general ledger accounts required by NCUA in section 2080.10 of the accounting manual.

Federal credit unions normally are examined twice each year. One exam is conducted by NCUA and the other exam is conducted by the membership of the credit union according to the FCU Act.

NCUA employs federal examiners who have the sole responsibility of conducting annual reviews of all federal credit unions. Credit unions may be subject to examinations of shorter intervals should the examiner believe it to be necessary. The purpose of the federal exam is primarily to protect the credit union's members. Therefore, the examinations focus on the quality of assets, liquidity, adequacy of retained earnings, abilities of management, potential for future earnings, review of loans, and compliance with appropriate laws and regulations. In their reviews, NCUA examiners will continue to classify shares as equity according to D. Michael Riley, NCUA's Director of Examination and Insurance.[9]

[9] "AICPA Suit Appealled," Credit Union Magazine, April 1987, p.18

Each credit union is required to have a supervisory committee elected by the membership or appointed by the board of directors. The committee, consisting of credit union members, is responsible for conducting an annual audit in addition to the federal examination. The audit report must be submitted to the board of directors and summarized for the entire membership at the credit union's annual meeting. An accounting firm may be engaged to conduct the annual audit for the supervisory committee.

CHAPTER III

AICPA RECLASSIFICATION

Reasons Supporting Reclassification

The AICPA recognized that reclassification would result in a departure from the accounting method currently required by federal regulatory authorities, which had been followed for more than fifty years. However, there were three primary reasons to support reclassification.

The first reason involved the owner's influence in relationship to his account balance. Each member is required to maintain only one share and each member has only one vote. There is no relationship between the balance of a member's account and his degree of control over the management of the credit union. Directors are elected at the annual meeting from the membership. Thus, individuals of modest means have an equal opportunity to influence the direction of the credit union with their vote as would a person with a sizeable account balance. Examining this reasoning, members' savings do not have the usual properties of owner equity.

The second reason supporting reclassification is the current financial statement presentation employed by mutually owned savings and loan associations and savings banks. The balance sheets of both mutual savings and loan associations and savings banks classify the member/owners' deposits as liabilities. Therefore, the equity sections consist primarily of retained earnings.

Savings banks and mutual savings and loan associations bear resemblances to credit unions in their form of ownership and purpose. Both operate under similar laws and regulations as credit unions. Savings banks are owned by the depositors with policies established by a board of trustees for the purpose of serving the depositors' needs. The trustees do not share in the bank's profits. The majority of savings and loan associations are also mutually owned by the savers.[10] The savers and borrowers each have a vote at the annual meetings. For savers, the number of votes allowed is based upon the amount of savings they have. Basically, one vote is allowed for each $100 in savings. Borrowers are allowed one vote. Savings deposits in both savings and loan associations and banks are insured by government agencies just as credit union shares are. In contrast, equity in either a capital stock savings and loan association or bank is not insured nor can equity capital be withdrawn.

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[10]AICPA, Savings and Loan Associations Audit and Accounting Guide (New York, N.Y.: AICPA, 1979), p.1

The ACIPA also believed that the classification of members' savings as liabilities is consistent with the concept of liabilities discussed in FASB Statement of Financial Accounting Concepts No. 6. FASB No.6 describes three characteristics of a liability. The entity must be obligated by an event which has already occurred and the obligation must require a transfer of assets at a specified date in the future or upon demand.

While not part of the AICPA's argument, FASB No.6 also describes the characteristics of equity. Equity is the original investment of assets by an owner and is increased by additional investments or reduced by distributions to owners. Distributions to the owners are not required and liabilities have priority status over owners' claims. Therefore, owners are at risk in the event of a loss but reap the benefits from profitable operations.

FASB Support

The audit issues in the Guide were referred to the FASB Board for review. Originally, the FASB intended to add the project to its calendar of issues to address.[11] However, in April of 1986, the Board decided that it would not review the Guide any further and encouraged the AICPA to issue the

[11]Financial Accounting Standards Board of the Financial Accounting Foundation, Financial Accounting Series No.020, Status Report No.174, April 7, 1986

Guide. In making this announcement, the FASB gave its unanimous support for classifying credit union members' share accounts as liabilities and earnings on share accounts as interest expense.

Audit Guide and Requirements of CPAs

The Guide notes five areas where the regulatory accounting practices differ from GAAP. Two of these practices relate to the classification of shares and the earnings on savings accounts. Shares are required to be classified as liabilities in the statement of financial condition with footnotes indicating the various classes of savings such as regular shares or share drafts. The equity section would normally include only retained earnings. If accounts are not included in the appropriate sections of the financial statements, the Guide instructs CPAs to qualify the audit opinion or issue an adverse opinion if the departures from GAAP are material. As a practical matter, most credit unions will be receiving qualified rather than unqualified audit reports (See audit reports in Appendix B). CPAs who are members of the AICPA may have to defend their work if they chose to ignore the Guide's recommendations.

CHAPTER IV

CREDIT UNION CONCERNS

Uniqueness of Credit Unions

The credit unions have continually maintained that, due to their cooperative nature where the members are the owners, they are unique financial entities unlike banks or savings and loan associations. The members have a voice in the management and have the purpose of providing low-cost financing to their fellow owners. A credit union is not intended to be profit oriented but instead operates under the premise of providing services at a fair cost with the net profit returned to the member/owner. The disbursement is in the form of dividends on the shares they own in the credit union. This is generally unlike other financial institutions which operate for the purpose of earning a profit.

Historically, credit unions have been formed by workers employed by one company. The workers needed access to low-cost credit and, by pooling their resources, could lend money to one another. These loans were generally made at lower interest rates than were being charged by the banks. Often credit was not even available to these individuals due to their financial circumstances.

Credit unions argue that this cooperative nature can only be identified by the classification of members' accounts as shares in the financial statements. Without this classification, a credit union would appear identical to any other financial institution.

Philosophy of Credit Unions

The philosophy of credit unions is for all members to benefit from their use of the credit union's services. Traditionally, they have focused on encouraging thrift among their members. Services provided were savings and lending. Since deregulation of banking, the 1980s have seen these institutions offering a wide range of new services such as share drafts and credit cards with the same motive of low-cost service to the members.

Members, as owners of credit unions, have the power to control the entity through their votes. By electing directors in a democractic process, they have a voice in the planning and operations of the entity. The board of directors and the supervisory committee are elected from the membership and serve on a volunteer basis. Services are only available to those individuals determined eligible for membership according to the credit union's common bond as approved by NCUA. The terminology describing the field of membership, which results from the common bond, is normally broad enough to allow a person to continue membership should he leave the common bond. No person can be a member without having first purchased at least one share. This ensures that only those persons with an interest in the future of the entity will be able to borrow funds or have access to any of the other services.

The dividend an individual earns on his shares is not risk-free as is the interest a depositor earns on a regular savings account in other financial institutions. Dividends are not declared until the end of the accounting period at which time there must be sufficient earnings available. In contrast, bank savings earn a stated rate of interest regardless of the profitability of the business. Credit unions can also restrict the amount of regular shares that can be withdrawn by a member at any given time. However, in practice, this rarely happens.

The credit union motto "not for profit, not for charity, but for service" expresses the philosophy of the credit union movement.

Legal Requirements of the Federal Credit Union Act

One of the major issues is the federal law and the resulting requirements found in the Federal Credit Union

Act. Most states also have similar legislation which applies to the state chartered credit unions. The proposed reclassification appears to be contrary to the law and the regulations which NCUA enforces. The federal law originally recognized credit unions as entities unique from other financial institutions and as a result provided them with a separate governing body. This body was empowered with the authority to make regulations guiding the future of the credit union movement. The AICPA decision appears to be contrary to the law, interferring with credit unions' rights and obligations expressed within the law.

Along with the concern for the future of the credit union movement, credit unions fear they will be subject to sanctions by NCUA if the financial statements they produce are not in the format required by NCUA. It will not be possible for financial statements to meet both the requirements of NCUA and the AICPA.

Best Interest of Credit Unions and Members

The AICPA believes that reclassification would make financial reporting clearer because the financial statements of all financial institutions would resemble each other. Credit unions are concerned that the reclassification would confuse members who would no longer see themselves being identified as owners.

Another problem would be the necessity of two sets of financial statements, one for auditors and another to satisfy the credit union's current needs. This would lead to duplication and increased costs.

Lenders requiring audited statements may not be aware that their loans would have priority over the account balances of members if savings are classified as liabilities. Creditors listed in financial statements normally have legal priority status over owners' claims against an entity. If lenders are unaware of the legal status of members' shares, they might assume that members have priority claims over creditors, similar to depositors in other financial institutions.

Any doubts in the minds of lenders as to the priority status of creditors' claims could cause higher interest charges and possibly higher collateral requirements in order for a credit union to secure any needed financing. These costs would decrease the amount of money available for dividends to credit union members. This potential threat is of greatest concern to large credit unions who must borrow funds to meet the borrowing needs of its members. This is a common practice among credit unions of all sizes when the economy is thriving. While this need is not present in many credit unions in today's economy, reclassification may jeopardize this practice in the future.

Credit unions believe they are presently operating in the best interests of their members and that any required changes can only be to the members' detriment.

CHAPTER V

RECENT EVENTS

Audit Guide Published

The Credit Union Audit Guide was published and made available in May, 1986. The Guide is to be effective for audits of accounting periods beginning after December 15, 1986. Because federal credit unions are required by law to maintain their accounting records on an annual basis, the Guide will actually be effective for audits of the 1987 financial statements which will occur in 1988. As a practical matter, CPAs have stated that they intend to use the guide as reference immediately rather than waiting until 1988[12]. It is a common practice of CPAs to place guides in use at the time they are issued, regardless of the date they actually become effective.

Lawsuit

CUNA and Navy FCU filed a civil action lawsuit in the United States District Court for the Western District of Wisconsin on September 25, 1986. The lawsuit presented three

[12] Plaintiffs' Brief in Opposition to Defendant's Motion to Dismiss, CUNA & Navy FCU v. AICPA, Case No. 86-C-712-S, United States District Court of Wisconsin, December 18, 1986, p.12.

claims and requested relief. The first two claims were for breach of duty and the final claim was for common-law misrepresentation. For a claim to exist, there must be an actual controversy which will result in wrongful injury to the plaintiff. The controversy was stated as the AICPA causing CPAs to classify credit union shares as liabilities. This classification would cause wrongful injury to CUNA and the individual credit unions.

The first breach of duty claim alleged that the AICPA and individual CPAs had a duty to accurately present the nature of credit union shares. Shares should be properly classified as equity according to the FCU Act and NCUA regulations. CPAs therefore have a duty to verify that statements are prepared according to the requirements of the law, showing that members' savings are the entity's equity.

The injury that may occur will be a result of creditors misinterpreting the financial status of a credit union. This could cause the credit union to be charged higher interest rates due to the assumed risk associated with low equity and high debt. Another concern was the potential for sanctions by NCUA because the prepared financial statements would be in noncompliance with the federal disclosure requirements.

The second claim was for breach of duty to use due care. CPAs have a duty to use due care in accurately presenting the financial condition of an entity. CPAs are also required to attest that the financial statements are presented in accordance with an issued audit guide. The financial condition of the credit union would not be accurately portrayed in its financial statements if shares were classified as liabilities rather than equity.

The stated injuries that would result are again the increased cost of borrowing money and also a potential liability for the credit union and directors. The directors have a duty to accurately portray the credit union's financial position. If the directors are remiss in their duty and a loss occurs, the directors could be held liable to the shareholders for the financial loss. Additional costs of borrowing would decrease the entity's earnings. Because the directors failed their duty to accurately present the credit union's financial position to the lenders, they could be held liable to the members for the decrease in earnings.

The common-law misrepresentation claim alleged that the nature of credit union shares will be misrepresented due to the balance sheet classification which is contrary to federal law. The financial condition of a credit union will appear less favorable due to the "false representation." The

AICPA will be a responsible party for the damage since it issued and distributed the Guide. Relief for negligent misrepresentation of financial condition was believed to be provided by established law from accountant malpractice suits and also under the Federal Securities Law.

The following relief was requested by the plaintiffs:

A. "A declaratory judgment that the defendant will breach its duty to credit unions, their directors, officers, members and trade associations, by issuing and distributing the Guide, and by requiring CPAs to conform their accounting functions to the Guide, which Guide requires that credit union shares be classified as liabilities. The standard classification will cause federal credit unions to be in noncompliance with federal disclosure requirements, inaccurately portrays the financial condition of credit unions, and misrepresents the nature of credit union shares."
B. "An order directing the defendant to withdraw the Guide and issue a correction ."
C. "An order prohibiting the defendant from issuing and distributing subsequent Guides requiring shares to be classified as liabilities."
D. "An order prohibiting the AICPA from compelling CPAs to classify shares as liabilities."
E. "Award of damages to plaintiff for its non-litigation expenses which have been or will be incurred."
F. "Award of costs and disbursements of this action that are incurred by the plaintiffs."
G. An award of such other relief as the court deems equitable."[13]

Arguments were presented in the case against the AICPA's classification of shares as liabilities. Credit union members' share accounts are subordinate to the liabilities of the credit union and the accounts also give the members voting rights. These are characteristics of

[13]Complaint, CUNA & Navy FCU V. AICPA, Case No. 86-C-712-S, United States District Court of Wisconsin, September 25, 1986, p. 12.

stockholders' equity rather than liabilities. In practice, credit unions have traditionally classified the accounts as equity which is the method required by the FCU Act and NCUA for more than fifty years.

Motion to Dismiss

The AICPA responded to the lawsuit by presenting a motion to dismiss on November 17, 1986 due to the fact that the court lacked subject matter jurisdiction over the claim. The reasons for dismissal were that the claim was not ripe for adjudication, CUNA lacked standing to assert the claims, and the claims were insufficient as a matter of law. According to the AICPA, the matter should not be a legal claim as the dispute was a topic which had received considerable attention by the accounting profession who had the authority to resolve the issue.

The question of ripeness had previously been resolved in other Supreme Court cases and involved a two-part test. The issue must be fit for a judicial decision (i.e., it must be a legal matter that can be decided by a judge) and the parties must prove that they would suffer a hardship if the court will not consider the case. The events that CUNA had speculated would occur would be difficult to prove without waiting until a later time to see if they did, in fact, occur. The injury CUNA had foreseen was not immediate so the

AICPA questioned whether there would be any hardship to the plaintiff. Credit unions had not altered their conduct as a result of the guide and the questions of obtaining future credit or possible sanctions by NCUA were believed to be purely speculative.

In its argument that CUNA lacked standing, the AICPA stated that since CUNA was not a credit union, the Guide would not apply to it nor to CUNA's members since they are the state leagues rather than individual credit unions. The AICPA's basis was a Supreme Court case where the court determined that an association may act on behalf of its members if either the association itself or the members would suffer direct injury. The AICPA argued that no party would be injured from the change in practice.

In order to establish a tort claim of misrepresentation, the defendant must make a representation of fact which is untrue. The plaintiff must believe that the statement is true and suffer some damage as a result of its reliance upon the statement. The AICPA argued that the Guide was opinion not fact as indicated in the Guide's statement that it "represents the considered opinion of the committee."[14] Because the Guide is opinion only, it could not be false. Also, the plaintiff did not believe the guide

[14]AICPA, <u>Audits of Credit Unions</u> (New York, NY: AICPA, 1986), p.iii.

was correct so had not as yet relied upon it or suffered any damage. The classification of members' accounts as equity rather than debt would generally cause a CPA to issue a qualified (except for) opinion. However, the AICPA believed the qualified opinion would not damage the credit unions.

Defending its position, CUNA filed a brief in opposition to the defendant's motion to dismiss. CUNA believed that there was no method of resolving the classification conflict without legal measures at this point; because the Guide was being distributed by the AICPA, no other action would be required to make it effective, and the AICPA felt that it alone had the authority to resolve the issue in the manner it chose. The purpose of the declaratory judgment action would be to resolve the legal dispute prior to actual injury occurring. CUNA cited the case of CUNA v. NCUA, 573 F. Supp. at 589, where a claim was filed concerning possible credit costs increasing. In that case, the court ruling allowed the consideration of the speculative increase due to the normal lenders' practice. The classification of shares as liabilities eliminates most of a credit union's equity while increasing debt. The result is an apparent adverse financial condition. CUNA presented affidavits indicating that the proposed events were likely to occur.

CUNA insisted that it had standing to bring a lawsuit in the representative capacity as credit unions' trade association. Even though CUNA's membership consisted of the state leagues, in reality, the leagues cannot be separated from the credit unions since they would have no purpose without the individual credit unions. In effect, the credit unions are the membership of CUNA. CUNA's damages at this point were the costs incurred in advising credit unions of the required reclassification.

Another argument opposing dismissal was the potential hardship credit unions were facing while the AICPA would not be caused any harm regardless of whether members' accounts were classed as liabilities or as equity. The credit unions would not be able to comply with the AICPA Guide and still satisfy the requirements of the federal law. Citing a number of cases, the plaintiff pointed out that a regulatory body, such as the AICPA, cannot enforce requirements to serve their own purpose rather than society's interest as a whole. In making regulations, there must be justification for the regulations beyond the mere convenience of the regulatory body. CUNA argued that many creditors would only accept unqualified opinions so that the classification of shares as liabilities would not give the same result as classifying shares as equity.

Memorandum & Order to Grant Motion to Dismiss

The court dismissed the case on February 25, 1987 with the decision stating that CUNA does have standing to bring a lawsuit on behalf of individual credit unions.

Recognizing that the Guide was the AICPA's final discussion of the matter, the court still believed that the potential harm was too uncertain for the case to be considered ripe for court. The court doubted that sophisticated lenders would have any difficulty dealing with reclassification. Lenders would recognize that reclassification is an accounting change rather than an economic change. The potential NCUA sanctions were also questioned.

The AICPA has a duty of due care to its members and the individual CPAs have a duty of due care to the credit unions they are hired to audit. The result of these relationships is that the AICPA could not be held liable for breach of contract to the individual credit unions since there would not be a legal agreement between the entities.

The final decision was that the first two claims lacked the immediate harm necessary for subject matter jurisdiction. The third claim was also dismissed because the classification was an opinion rather than a fact. A claim for misrepresentation cannot be based upon an opinion.

Appeal

CUNA and Navy FCU appealed the decision to the United States Court of Appeals for the Seventh Circuit on March 20, 1987. At the present time, CUNA is recommending that credit unions continue to classify shares as equity rather than liabilities.

CHAPTER VI

BALANCE SHEETS

Comparison of Balance Sheets

The balance sheets found in the following tables show the differences between balance sheet formats of financial institutions in Missoula. As can be seen in Table 1, credit unions do not currently classify members' savings accounts as liabilities. Instead, shares are listed as owners' equity. In addition, NCUA regulations require that the members' deposits be listed according to the type of accounts. For example, separate totals are presented for share certificates, share draft accounts, other member savings, and money market shares. This provides a reader of the financial statements with information concerning the type of accounts and stability of the funds. For example, the balances in share draft accounts could vary considerably due to the nature of checking type accounts. However, share certificate and money market share account balances would not have as much volatility.

The reserves (retained earnings) section is the final division on the credit portion of the statement. Here the regular or statutory reserve, appropriated undivided earnings and undivided earnings are shown. These accounts are similar to the retained earnings in any corporation as these accounts represent a portion of the business' income which was not paid to the stockholders. For a credit union, the regular reserve is a required percentage of gross income which is not available as dividends due to legal restrictions. Appropriated retained earnings will not be paid out as dividends as a result of decisions made by the board of directors. Undivided earnings may be made available to members in the future in the form of dividends at the discretion of the board of directors.

The sample savings and loan association shown in Table 2 is mutually owned and therefore shows no stockholders' equity other than retained earnings. All members' deposits are regarded as liabilities. The balance sheet in Table 2 gives an example of the financial presentation of a typical mutually owned savings and loan association. The liabilities section lists deposits as the first item even though these institutions are owned by the depositors in much the same manner as credit unions are owned by their members. The equity section of a mutually owned savings and loan association only includes retained earnings. Some savings and loan associations are stock savings and loans where the stockholders are individuals other than the depositors. In these cases, the stockholders have separate interests from the depositors. A stock savings and loan association would have deposits listed as liabilities which have legal priority over the equity of the stockholders.

The banks in the local area are not mutually owned. Table 3 presents the typical balance sheet of a bank showing the deposits of account holders as liabilities and the separate interests of the stockholders as equity. This presentation is the same format as that of a stock savings and loan association. The depositors have no interest in the institution other than claims for their account balances. Depositors are not entitled to share in any distribution from retained earnings. At the same time, stockholders receive a portion of the bank's income through dividends and have a management interest in the business. Unlike depositors, shareholders could lose their investment if the bank is unsuccessful.

The credit union balance sheet when restated as required by the Audit Guide will use the format of a mutually owned savings and loan association (see Table 4). The members' deposits will no longer be shown as equity but will be listed as a liability instead. Credit unions are naturally concerned over this change because classification as a liability is a significant change from the current classification as equity. This change causes a credit union to now show a significantly smaller amount of equity because retained earnings will be the only accounts remaining in this section. Despite the change in the appearance of the balance sheet, the legal nature of credit union shares has not changed. Shares will continue to be treated as equity in the event of liquidation with all liabilities continuing to have priority status. For this reason, the credit union's financial soundness has not been affected.

Credit Union Uniqueness Reflected in Balance Sheets

CUNA has argued that credit unions are unique financial institutions. Credit unions, savings and loan associations, and banks originally serviced distinct market groups. Savings and loan associations used savings deposits to provide home financing to individuals while banks used savings deposits to provide commercial loans and consumer loans to stable customers. Banks were also the only institutions who provided services such as checking accounts and charge cards. Both banks and savings and loan associations were open to the general public.

Credit unions originally served a specific market niche. The target market consisted of individuals within a well-defined field of membership established by a common bond. Consumer loans were made to members from the savings deposits of other members. Originally, the banking industry was highly regulated by the government and the three types of institutions were generally not in direct competition with one another.

Another important aspect of credit union operations is the volunteers who guide the individual credit unions. The board of directors, credit committee, and supervisory committee all consist of members of the credit union who are not paid for their service to the credit union. Generally, the manager and office staff are paid employees. In contrast, the board of directors of other financial institutions are compensated.

Another argument for the uniqueness of credit unions is the legal status of members' shares. The members' savings in a credit union are considered to be at risk because they are owners' equity and do not have the legal status of creditors. Members are not guaranteed a specific interest rate return on their savings. In contrast, banks and savings and loan associations quote a specific interest rate to be paid. Because the depositors are creditors, these rates must be paid regardless of the institution's earnings in the current period. In practice, credit unions also quote a specific rate but they cannot legally pay a dividend unless the organization had sufficient earnings to cover it. Because the members are the owners, they are not entitled to receive a dividend if the organization lacked earnings.

The democratic principle under which credit unions operate is unique to credit unions. Credit unions are the only financial institutions where each individual is entitled to only one vote regardless of his financial interest in the institution. Credit unions have also operated under the principle of providing affordable services to the members rather than attempting to earn profits for the stockholders.

Credit unions have relied upon the structure of the balance sheet to convey the uniqueness of their ownership and operations. In fact, the member ownership principle portrayed in the balance sheet has been greatly responsible for the credit unions' ability to avoid federal and state taxation.[15] Currently, all other financial institutions are subject to federal and state corporate taxation.

While some of the characteristics which make credit unions unique are still apparent, since deregulation of banking during the 1980s, services of all financial

[15]Credit Union National Association,"Shares, Liabilities and the AICPA" (pamphlet)

institutions have become more alike and the institutions are often competing for the same individuals' business. For instance, all financial institutions can now offer checking accounts and credit cards. They also quote similar loan rates and pay similar savings rates. In addition, the move to larger community chartered credit unions rather than small, close-knit groups has allowed more people to have access to credit union services. These changes have caused credit unions, banks, and savings and loan associations to enter into head-to-head competition in some communities. The trend toward community charters and more bank-like services threatens the uniqueness of credit unions.

TABLE 1

Credit Union Balance Sheet

Federal Credit Union
Statement of Financial Condition
As of December 31, 1986

Assets	
Loans, net of allowance for loan losses (Note 3)	$9,450,179
Cash	1,344,375
Investments (Notes 2 and 6)	10,829,668
Property and Equipment (Note 4)	495,366
Central Liquidity Facility stock, at cost	--
Other assets	428,044
Total Assets	$22,547,632
Liabilities and Equity	
Borrowed funds (Note 6)	$ 25,000
Accrued and other liabilities	336,319
Commitments and contingent liabilities (Note 9)	--
Total Liabilities	$ 361,319
Savings accounts (Note 5)	21,341,776
Retained earnings, substantially restricted (Note 7)	844,537
Total Liabilities and Equity	$22,547,632

Accompanying notes are an integral part of these financial statements.

(Source: Missoula Federal Credit Union)

TABLE 2

Savings & Loan Association Balance Sheet

Savings & Loan Association*
Statement of Financial Condition
As of December 31, 1986

Assets	
Mortgage Loans	$165,726,000
Other Loans	10,413,000
Cash and Securities	44,738,000
Other assets	14,015,000
Total Assets	$234,892,000
Liabilities and Equity	
Deposits (Note 2)	$195,493,000
Borrowed Funds	20,367,000
Accrued and other liabilities	6,277,000
Total Liabilities	$222,137,000
Retained earnings, substantially restricted (Note 3)	12,755,000
Total Liabilities and Equity	$234,892,000

Accompanying notes are an integral part of these financial statements.

*Mutually owned.

(Source: Western Federal Savings & Loan Association of Montana)

TABLE 3

Bank Balance Sheet

Bank*
Statement of Financial Condition
As of December 31, 1986

Assets	
Cash	$ 4,301,000
Investments (Notes 2 and 6)	4,261,000
Federal Funds Sold	2,290,000
Loans, net of allowance for loan losses (Note 3)	35,909,000
Property and Equipment (Note 4)	2,529,000
Other assets	949,000
Total Assets	$50,239,000
Liabilities and Equity	
Deposits (Note 5)	$45,231,000
Accrued and other liabilities	1,840,000
Total Liabilities	$47,071,000
Common Stock	675,000
Retained earnings	2,493,000
Total Liabilities and Equity	$50,239,000

Accompanying notes are an integral part of these financial statements.

*Banks in Missoula are not mutually owned.

(Source: Montana Bank of South Missoula)

TABLE 4

Reclassified Credit Union Balance Sheet

Federal Credit Union
Statement of Financial Condition
As of December 31, 1986

Assets	
Loans, net of allowance for loan losses (Note 3)	$9,450,179
Cash	1,344,375
Investments (Notes 2 and 6)	10,829,668
Property and Equipment (Note 4)	495,366
Central Liquidity Facility stock, at cost	--
Other assets	428,044
Total Assets	$22,547,632
Liabilities and Equity	
Savings accounts (Note 5)	$21,341,776
Borrowed funds (Note 6)	25,000
Accrued and other liabilities	336,319
Commitments and contingent liabilities (Note 9)	--
Total Liabilities	$21,703,095
Retained earnings, substantially restricted (Note 7)	844,537
Total Liabilities and Equity	$22,547,632

Accompanying notes are an integral part of these financial statements.

(**Format** Source: AICPA, Audits of Credit Unions (New York, NY: AICPA, 1986), p.72)

CHAPTER VII

CONCLUSION

Discussion of Issue

In the lawsuit between CUNA and the AICPA, both parties have expressed valid concerns over the classification of credit union members' savings accounts. Unfortunately, the classifications desired by each group are mutually exclusive. One might assume that the distinction between equity and liabilities can be easily determined. However, while the concepts are clear, the distinction may not be clear in practice.[16]

Several types of securities, such as preferred stock or convertible debt, have the appearance of both debt and equity. NCUA at the present time requires credit union shares to be recorded as equity. However, the classification of a security should reflect its economic nature rather than simply a legal requirement. The problem of deciding whether a security is really debt or equity requires applying the definitions found in FASB Concept No. 6. Liabilities have

[16]AICPA, Professional Standards, Volume 3, Accounting, (New York, NY: Commerce Clearing House, 1981), AC 1230.049 p.7862.

the following three characteristics:

- an obligation exists
- the incident creating the obligation has already occurred
- the obligation must be repaid at a specific time in the future or upon demand.

The characteristics of equity are as follows:

- original investment of assets by owner
- equity is increased by additional owner investments
- equity is decreased by distributions to owner
- distributions to owners are not required
- liabilities have priority status over owners' claims
- equity is at risk if operation losses occur and gains when operations are profitable.[17]

Members' savings accounts appear to have the three characteristics of liabilities. That is, an obligation is created when a member deposits money and the obligation is expected to be repaid in the future. Credit unions argue that a debtor-creditor relationship does not exist especially since the FCU Act does not recognize a debtor-creditor relationship. However, there is no doubt that a member depositing his money in a credit union expects the credit union to repay the funds upon demand. Regardless of the specifics of the law, credit union members expect their funds to be available for withdrawal just as they would be at any other financial institution. While CUNA has argued that a credit union has the right to place restrictions upon the access to funds, this seldom occurs in practice.

[17]AICPA, Professional Standards, Volume 3, Accounting, (New York, NY: Commerce Clearing House, 1981), AC 1230.029-AC1230.049, p.7861-11-7862.

An examination of the characteristics of equity could lead one to accept the idea that credit union shares are equity. Certainly, they are the original investment of assets by owners both in economic substance and by law. The original charter of a credit union clearly shows the par value of shares and the number of shares subscribed to by each incorporator. The entity has no other owners or capital at that point in time. Equity is increased by additional member/owner investments and decreased when distributions are made to the member/owners. Distributions in the form of dividends cannot be required. By law, dividends on shares cannot exceed the current or retained earnings of the institution so cannot be guaranteed. This is a distinction from banks and savings and loan associations where account holders receive interest paid on their account balances regardless of the entity's earnings.

By definition, equity is at risk in the event of loss and accrues profits from operations. Credit union members receive the organization's profits in the form of dividends and their share accounts could be written down due to excessive losses. However, the members do not face serious risk of loss due to the federal share insurance. Future earnings or dividends are the only amounts not insured by NCUA and therefore the only amounts truly at risk. Most members would not perceive any greater risk than if their funds were deposited in a savings account at a bank.

Owners' claims do not have priority status over liabilities. This is another area where members' share accounts resemble equity. In the event of liquidation, other creditors would be paid prior to credit union members. Again the federal share insurance does mitigate this effect as members would be assured of receiving their money at some point in the future.

A problem in classifying members' share accounts as equity stems from the number of votes allowed and the subsequent control over the entity. All credit union members are allowed only one vote regardless of the amount of their savings or shares. The ownership rights which normally exist with equity vary depending upon the percentage of ownership. For instance, assuming par value is established at $5, a member who deposits $100 would theoretically have twenty votes compared to two hundred votes allowed a member who deposits $1000. This relationship does not exist in credit unions. The philosophy of credit unions is to allow all owners the same amount of control over the entity regardless of their economic means.

Considering the definitions of equity and liabilities, it appears that credit union shares have characteristics of both securities. However, because these classifications must be mutually exclusive, a decision must be made as to which classification appears the most appropriate. Perhaps an argument could be made for recording the ownership interest (par value of one share) separately from the remainder of the savings account if the credit unions'concern is truly to clearly indicate the member ownership principle in the financial statements. For example, if a member's account balance is $100, the account could be divided into a $5 par value share and $95 in savings. The savings account would then be classified as liability and the $5 share classified as equity.

Implications of Reclassification

One goal of reclassification is to make the balance sheets of credit unions appear comparable to the balance sheets of mutual savings and loans associations and savings banks. While the ownerships of these entities are similiar, it could be argued that reclassification for this reason will serve primarily to make auditing simpler for CPAs rather than to eliminate any confusion being caused by the current classification. There does not appear to be any documented problems resulting from the present classification method. In fact, prior to the issuance of the Audit Guide, accountants recognized credit union shares as equity. CUNA has argued that credit unions have not changed in any manner that would justify reclassification. However, since deregulation of financial institutions, credit unions have added additional services such as share draft accounts (i.e.,checking accounts), which changes their original structure.

One potential result from reclassification could be the future taxation of credit unions. Credit unions have barely avoided taxation in the past few years, primarily because of the nonprofit status and member ownership shown by the structure of the financial statements. A change in structure, combined with the similarities in services, may contribute to the argument that credit unions, banks, and savings and loans associations are all alike and should all be taxed in the same manner. For a credit union in the $20 to $50 million range, the average tax bill is projected to be $103,640. This would represent approximately 3.4% of gross income or 10.2% of operating expenses.[18] This reduction in income would cause credit union members to

[18]Montana Credit Union League, Letter to Credit Union Managers, July 1, 1987, Helena, MT

receive lower dividends. While a taxation issue should in no way influence the development of accounting practice, credit unions must be aware of this possible result of reclassification.

Reclassification will cause credit unions to choose between issuing two sets of financial statements or receiving a qualified opinion on statements issued in the present format. NCUA has stated that it will continue to require share accounts to be classified as equity. Some credit unions are also required by their state charters and by lenders to provide audited financial statements on an annual basis. Some of these interested parties require that the opinion be unqualified. For instance, some states require that the credit union receive an unqualified opinion on its financial statements in order to continue operations. Credit unions will be forced to issue two sets of financial statements in order to satisfy the requirements of both NCUA and the auditors. This duplication will lead to only slightly increased costs because the same information is required to be presented in both statements and will not require any additional effort to accumulate.

It is not clear what sanctions NCUA might employ if credit unions submit financial statements prepared as required in the Audit Guide, but it does have the authority to force a credit union to cease operations if the members' interests might be impaired. Certainly any measures taken because of incorrect classification would not be this drastic and can be avoided by preparing both sets of statements.

Some credit unions may refuse to prepare two sets of statements for several reasons, primarily because of their philosophy. The credit union members are the owners. It would not seem reasonable to portray the owners of an entity as creditors rather than owners. Another reason would be the added cost and effort to prepare the two sets of statements. It may seem like an unnecessary burden to credit union managers.

If a credit union chooses not to issue two sets of financial statements, the effects of a qualified opinion may not be easily determinable. To unsophisticated credit union members, a qualified opinion could be alarming, causing them to question the soundness of the credit union. While some members may be reluctant to deposit funds, most members of large credit unions probably do not examine the statements or read the auditor's opinion.

Small credit unions with active memberships will actually not be affected by reclassification as their statements are normally only reviewed by their supervisory committee rather than by independent CPAs. Sophisticated lenders, with whom credit unions should be dealing, would recognize that reclassification merely changes the appearance of the balance sheet but doesn't threaten the soundness of the entity. As mentioned earlier, some individual states, such as California, require state chartered credit unions to provide an unqualified opinion from a CPA on the financial statements in order to continue operations. In a recent decision, California has decided to accept a qualified opinion if the shares classification is the only departure from GAAP.[19] Other states may follow California's decision or they may continue to require unqualified opinions.

Small credit unions will undoubtedly continue to issue financial statements which satisfy only the requirements of NCUA. Large credit unions may be issuing statements in either format depending upon their circumstances. The potential result is that credit unions will not consistently utilize one balance sheet format. This inconsistency could cause confusion among interested parties. Currently, these parties understand the credit union statements and can easily compare statements from different credit unions.

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[19]"California OKs Qualified Audits," Credit Union Newswatch, February 9, 1987, p.2

Concern has been expressed over specific debt ratios which lenders may require. In the case of Navy FCU, the debt ratio changes from 3% to 93%. Using the local financial statements in Chapter VI, the credit union would have a debt ratio of 96% as opposed to 2%. However, this ratio compares favorably with the bank's debt ratio of 94% and the mutual savings and loan association's debt ratio of 95%. The market should recognize that the credit unions have not changed even though the debt ratio has changed. If all financial institutions are treated equally by lenders, then the new debt ratio should not have any consequences.

A final question is credit unions' ability to continue as unique organizations. As credit unions offer more bank-like services and present financial statements which resemble those of other mutually owned financial institutions, questions may arise concerning the focus and philosophy of credit unions.

Summary

In theory, accounting procedures can be easily described. Unfortunately, theory is sometimes difficult to apply to practical problems. The AICPA's reclassification of shareholders' equity to liabilities in the balance sheets of credit unions has caused dissent among professionals in the accounting field along with the filing of a lawsuit against the AICPA on behalf of the credit unions. If the correct classification was readily apparent, the dispute would have no basis. The following quote from the court's memorandum and order to dismiss the case summarizes the issue:

> "(The dispute is the) epitome of the abstract question case. The AICPA has issued what amounts to an opinion about the best way to classify share accounts... Plaintiffs' complaint would require this Court to decide whether plaintiffs' or defendant's method of accounting for shares is correct. There are not only no legal principles applicable to the question; there is simply no correct answer...These disputes, like this one, are real enough, but they are ideological, not legal. The answer to the appropriate classification of share accounts is in the eye of the classifier."[20]

[20]Memorandum and Order, CUNA & Navy FCU v. AICPA, Case No. 86-C-712-S, United States District Court of Wisconsin, February 25, 1987, p.8

APPENDIX A

Statement of Financial Condition
Required NCUA Format

Internal Use Only Report Type ____ | Acct Code No. 100 | Charter # or Ins. Cert. #

STATEMENT OF FINANCIAL CONDITION AS OF ________ ________, 19__

________ CREDIT UNION

ASSETS:

LOANS & CASH	$ Amount	¢	Acct code no.
1. a. Outstanding balances of lines of credit loans to members			702
b. Real estate loans to members (first lien) (Orig maturity over 12 years)			703
c. Loan balances fully secured by shares			706
d. All other loans to members (excluding a,b,c, above)			001
e. Total loans to members (include items a,b,c, and d)			700
2. All other loan accounts (excluding amts. in 1,a,b,c,&d)			710
3. (Less) Allowance for loan losses			719
4. Net Loans Outstanding (Sum of 1 e plus 2 less 3)			002
5. Cash (cash on hand, petty cash, checking accts., etc.)			730

INVESTMENTS (A + B = C)	Remaining Maturities A. 1 Yr. or less	B. More than 1 Yr.	C. Total $	¢	
6. U.S. Govt. Obligations					741
7. Federal agency securities					742
8. Common trust investments					743
9. Shares, deposits, & certif. in corp. centrals					744
10. Shares, deposits, & certif. in other CUs					745
11. Shares, deposits, & certif. in banks S&L's & MSB's					746
12. Loans to other credit unions					747
13. All other investments					003
14. Shares in Central Liquidity Facility (Direct or Indirect)					751
15. (Less) Allowance for investment losses					799
16. Net Investments (Sum of 6 through 14 Less 15)					004

OTHER ASSETS	$	¢	
17. Land and building (net of depreciation)			007
18. Other fixed assets (net of depreciation)			008
19. Monetary control reserve deposits			783
20. All other assets			009
21. TOTAL ASSETS (Sum of 4,5,16 & 17 through 20)			010

LIABILITIES SAVINGS EQUITY

(A + B = C)	Remaining Maturities A. 1 Yr. or less	B. More than 1 Yr	C. Total $	¢	Acct code no.
22. Promissory notes					812
23. Reverse Repurchase Transac.					813
24. Other notes Payable					814
25. Interest payable					816
26. Accounts payable					800
27. Dividends/interest on shares/deposit payable					820
28. All other liabilities					012
29. Total Liabilities (Sum of 22 through 28)					011

	Remaining Maturities A. 1 Yr. or less	B. More than 1 Yr	C. Total $	¢	
30. a. Share certificates					908
b. Share draft accounts					902
c. Member Deposits (SCU's Only)					006
d. Other member savings					006
e. Non-member Savings					920
f. Total savings/shares/deposits (Sum of 30a through 30e)					013

	$	¢	
31. Regular/statutory reserve			931
32. Investment Valuation reserve (SCU's only)			015
33. Special Reserves			016
34. Other reserves			017
35. Undivided Earnings			940
36. Net Income (Loss)			660
37. TOTAL LIABILITIES SAVINGS & EQUITY (Sum of 29, 30f and 31 through 36)			014

MARKET VALUES OF INVESTMENTS	Remaining Maturities A. 1 Yr. or less	B. More than 1 Yr.	C. Total $	¢	
38. U.S. Government Obligations					018
39. Federal agency securities					019
40. a. All other investments					020
b. ________					021

*Numbers in this column refer to notes to financial statements, letters refer to supplementary schedules which are attached.

FCU 109-A Rev. 81 [illegible] 11214

APPENDIX B

UNQUALIFIED AUDIT REPORT

To the Board of Directors
Sample Credit Union
Sampletown, U.S.A.

We have examined the accompanying statements of financial condition of Sample Credit Union as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and other such auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial condition of Sample Credit Union at December 31, 19X2 and 19X1, and the results of its operations and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Signature

Office town, U.S.A.
Month Day, 19X3

(Source: AICPA, Audits of Credit Unions (New York, NY: AICPA, 1986), p.71

QUALIFIED AUDIT REPORT

To the Board of Directors
Sample Credit Union
Sampletown, U.S.A.

We have examined the accompanying statements of financial condition of Sample Credit Union as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and other such auditing procedures as we considered necessary in the circumstances.

The credit union has classified savings (shares) as equity as required by the National Credit Union Administration. This method of accounting is not in conformity with generally accepted accounting principles which requires savings to be classified as liabilities. If the credit union were to classify savings as liabilities, liabilities would increase and equity decrease by $..... and by $..... for the years ended December 31, 19X2 and 19X1, respectively.

In our opinion, except for the effects of classifying savings (shares) as equity, as discussed in the preceding paragraph, the financial statements referred to above present fairly the financial condition of Sample Credit Union at December 31, 19X2 and 19X1, and the results of its operations and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Signature

Office town, U.S.A.
Month Day, 19X3

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