



CU* Answers

Internal Audit Report National Automated Clearing House Association (NACHA)

July 2010

CU* Answers

Internal Audit Report NACHA

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I. Executive Summary

Crowe Horwath LLP (Crowe) performed the ACH annual audit, as promulgated by the National Automated Clearing House Association ("NACHA") of CU* Answers as of June 30, 2010.

OVERVIEW

The overall objective was to assess ACH compliance with respect to the 2010 NACHA Operating Rules (Sections 8.1 General Audit Requirements for Participating Depository Financial Institutions and Section 8.2 – Audit Requirements of Participating Financial Institutions). The Company does not perform origination services for members and therefore was not required to complete Section 8.3 (Audit Requirements of Originating Depository Financial Institutions).

We read selected policies and procedures, discussed compliance with these policies and procedures with the various personnel, and in some cases inspected certain detail records.

Your Internal Auditor approved our work plan and we communicated the work we did and our results to management and your Internal Auditor.

REPORTING METHODOLOGY

In this report, we provide a summary of our results and recommendations as well as management's responses. To assist you in analyzing our recommendations, we have provided our suggestions for corrective action based on the finding's exposure to loss or increased regulatory scrutiny, as follows:

High – Requires *immediate* remedy and, if left uncorrected, exposes CU* Answers to significant or immediate risk of loss, asset misappropriation, data compromise or interruption, fines and penalties, or increased regulatory scrutiny.

Moderate – Requires *timely* remedy and, if left uncorrected, may expose CU* Answers to risk of loss or misappropriation of company assets, compromise of data, fines and penalties, or increased regulatory scrutiny. These issues should be resolved in a timely manner, but after any high priority issues.

Low – Should be addressed as time and resources permit. While it is not considered to represent significant or immediate risk, repeated oversights without corrective action or compensating controls could lead to increased exposure or scrutiny.

Best Practice – Represents operational efficiencies or improvements for consideration by management based on industry best practices and Crowe's experiences.

SUMMARY OF RESULTS

The table below displays the number of recommendations identified through our procedures, categorized by priority.

Area of Assessment	High	Moderate	Low	Best Practice
NACHA	-	1	-	1
Total	-	1	-	1

No critical issues were identified during this assessment. Detailed observations and recommendations are provided in Section II – Results and Recommendations. These items are issues that do not represent a significant risk at this time, but offer opportunities for CU* Answers to further strengthen controls and processes.

Thank you for this opportunity to report the results of our procedures. We also wish to thank the various CU* Answers personnel for their cooperation and assistance.

II. Operational Results and Recommendations

Finding #1: *CU* Answers Services Agreement*

Risk Rating: *Moderate*

During our review of the CU* Answers Services Agreement established with member institutions, we found that agreement only states the following in regards to the processing services offered to member institutions: "Member ACH Processing including Overdraft, NSF, GL Account and Multiple Account Transfers based on Contract Assigned Vendor." It does not appear as if this statement fully addresses the roles and responsibilities of each party in regards the ACH processing services offered by CU* Answers (i.e.- Sending/Receiving Point) which is required by NACHA.

Recommendation

We recommend management consider modifying their Services Agreement to fully address the roles and responsibilities of each party in regards the ACH processing services offered by CU* Answer, to include but not limited to:

- How entries shall be transmitted to and from each party;
- The format of the ACH file transmitted;
- The handling of the ACH operator's file acknowledgements as outlined in Section II Chapter II(L)(2) of the NACHA Operating Guidelines;
- Posting timeframes; and
- Notification of errors, and guidelines regarding reversal entries and reversing files.

Management's Action Plan

Management has updated the Services Agreement to include the following language:

ACH OPERATOR SERVICES

In the event Customer requests CU*Answers to provide ACH Operator Services, the following terms and conditions shall apply to the ACH Operator Services:

1. Term. This Agreement shall expire or terminate with the expiration or termination of the Agreement, provided that Customer may terminate the ACH Services at any time providing CU*Answers not less than thirty (30) days prior notice of such termination. The termination of this Addendum shall be without charge or liability to Customer.
2. Services. The ACH Services provided by CU*Answers to Customer are as follows:
 - (a) Returns Originated by Customer. With respect to ACH returns originated by Customer, CU*Answers will:
 - (i) Acting on instructions from Customer, create daily return and NOC files within the deadlines set by the ACH Operator and other applicable processing schedules, and
 - (ii) Transmit credit and debit entries initiated by Customer into the ACH system as provided by NACHA rules.

- (b) Files Received from ACH Operator. With respect to ACH files originated by a third party, CU*Answers will:
- (i) Receive ACH files for Customer that have been routed through the ACH Operator via CU*Answers and will process those files for Customer using the ACH System.
 - (ii) Route all files of the Customer made available by the ACH Operator through CU*Answers in accordance with the then applicable processing schedule.
 - (iii) Make entries on the Customer's general books to reflect the settlement of funds for ACH transactions between the Customer and its settlement agent for transaction received from the ACH Operator through CU*Answers.
 - (iv) Provide the means to reverse and/or repost files received from the ACH Operator through CU*Answers, upon request, for up to three (3) business days after settlement date of the original file.
 - (v) Credits will be processed in accordance with NACHA rules and Customer requests. Debits will be processed in accordance with NACHA rules.

3. Other Obligations of the Parties.

- (a) Other CU*Answers Obligations. In addition to the obligations set forth in Sections 1 and 2 above, CU*Answers will:
- (i) Process file received after the applicable daily deadline within the next days' business;
 - (ii) Upon being advised by Customer of Customer's initiating a file in error, notify CU*Answers of the error and request an adjusting entry, if necessary. If CU*Answers is
 - (A) Unable to correct the error prior to submitting it to the ACH Operator, or
 - (B) Unable to withdraw the item from the ACH Operator,CU*Answers will send the correcting file or entry provided by the Customer.
 - (iii) Provide electronically stored reports necessary to provide audit trails of all originated and received ACH files. Such reports will be housed and encrypted in storage accordance with NACHA archival requirements, and will be promptly provided to Customer upon request.
- (b) Other Customer Obligations. Customer will:
- (i) Notify CU*Answers of any entry that Customer has initiated in error and provide CU*Answers with a description of the error. In the event CU*Answers is unable to

withdraw an item which Customer has notified CU*Answers was submitted in error, Customer shall provide CU*Answers with a correcting file or entry within five (5) business days after the midnight settlement date for the item submitted in error;

- (ii) Determine whether to send pre-notifications on new accounts. In the event Customer determines that it will send pre-notifications, Customer will send pre-notification (zero dollar entries) in a format and medium which complies with NACHA rules, at least six (6) days prior to initiating the first live (once cent or more) entries to a particular account. In the event pre-notification is rejected, Customer will not initiate further entries until the reasons for the rejection are resolved; and
 - (iii) Handle all returns, notifications of change and member inquires in accordance with NACHA rules.
- (c) Joint Obligations. CU*Answers and Customer will comply with applicable ACH and NACHA rules, including annual self-audits.
4. Fees. The ACH Services agreement are provided by CU*Answers without increase to the fees payable CU*Answers by the Customer pursuant to the Agreement; provided that the fees for ACH Services may be increased by CU*Answers as provided elsewhere in the agreement.
5. Indemnification. Customer will indemnify, defend, and hold harmless CU*Answers, its officers, directors, shareholders, owners, employees, agents and affiliates from and against any claims, losses, damages, liabilities or expenses (including, without limitation, reasonable attorney's fees and expenses) resulting from or arising out of entries initiated by Customer which are not in compliance with applicable ACH rules.

Individual(s) Responsible: Patrick Sickels

Due Date: October 1, 2010

Finding #2: *Prenotification Reports*

Risk Rating: *Best Practice*

We found that CU* Answers provides their member institutions with system generated reports that identify all incoming prenotifications. However, we found these reports do not identify those prenotifications that contain inaccurate account/transaction information that would cause an entry to non-post (similar to how standard ACH reports identify those entries with inaccurate account/transaction information). Therefore, member institutions must implement a manual prenotification review process to identify those with inaccurate information in order to fulfill their NACHA requirements of returning these within the required deadlines.

Recommendation

We recommend management consider modifying their prenotification report to specifically identify those prenotifications that contain inaccurate account/transaction information that would cause an entry to nonpost. This would enable member institutions to discontinue their daily prenotification research process.

Management's Action Plan

Our initial review indicated CU*Answers does not have the capability to easily generate these reports. If this becomes a more serious issue in the future, we will reconsider and develop a project plan around this to determine the scope of work required.

III. Summary of Scope

The scope of procedures included inquiry and/or testing in the following activities and processes:

- Performed the audit requirements as indicated within Appendix Eight – Rule Compliance Audit Requirements of the 2010 NACHA Operating Rules – Section 8.1 – General Audit Requirements.
- Performed the applicable audit requirements as indicated within Appendix Eight – Rule Compliance Audit Requirements of the 2010 NACHA Operating Rules – Section 8.2 – Audit Requirements for Participating Depository Financial Institutions over the following ACH operations for receiving depository financial institutions: Record Retention, Annual Audit Requirement, Acceptance of Entries, Credit availability and debit posting and ACH data security.

The scope did not include the audit requirements as indicated within Appendix Eight- Section 8.3- Audit Requirements for Originating Financial Institutions as the company does not perform origination services for corporate businesses. Compliance with the requirements of this section would be the responsibility of the member credit union.

The specific procedures performed were based on the concepts of selective testing. Although our testing was performed in some areas without exception, we can provide no assurance that exceptions would not have been detected had procedures been changed or expanded.

It should also be recognized that internal controls are designed to provide reasonable, but not absolute, assurance that errors and irregularities will not occur, and that procedures are performed in accordance with management's intentions. There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal controls. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes in judgment, carelessness, or other factors. Internal control procedures can be circumvented intentionally by management with respect to the execution and recording of transactions, or with respect to the estimates and judgments required in the processing of data. Controls may become ineffective due to newly identified business or technology exposures. Further, the projection of any evaluation of internal control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, and that the degree of compliance with procedures may deteriorate.