NATIONAL CREDIT UNION ADMINISTRATION
OFFICE OF INSPECTOR GENERAL

REVIEW OF NCUA'S PROCESS FOR DOCUMENTING SHARE INSURANCE FUND LOSSES AND CREDIT UNION FAILURES

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Acronyms and Abbreviations

ALMS	Asset Liquidation Management System
AM	Assisted Merger
AMAC	Asset Management and Assistance Center
CU	Credit Union
E&I	Office of Examination and Insurance
FCU	Federal Credit Union
LIQ	Liquidation
MIS	Management Information System
NCUA	National Credit Union Administration
NCUSIF	National Credit Union Share Insurance Fund
OCFO	Office of Chief Financial Officer
OCP	Office of Consumer Protection
OIG	Office of Inspector General
PACA	Office of Public and Congressional Affairs
P&A	Purchase and Assumption Agreement
UAM	Unassisted Merger

EXECUTIVE SUMMARY

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) conducted a self-initiated review of NCUA's process for documenting credit union failures and their associated share insurance fund losses. Our objective for this review was to determine NCUA's methodology for identifying and tracking credit union failures and losses to the National Credit Union Share Insurance Fund (NCUSIF or SIF). To accomplish our objective, we performed statistical analysis of NCUA's ability to document credit union failures[1] and related estimated SIF losses at different points in time. We analyzed losses and failures at the time of occurrence, at year-end, and for the period ending July 31, 2012. The scope of our review covered all failures occurring during calendar year 2011 and from January 1 through July 31, 2012. We reviewed and analyzed credit union failures and SIF loss data, as well as information obtained from NCUA's five regional offices, the Asset Management and Assistance Center (AMAC), the Office of Examination and Insurance (E&I), the Office of Consumer Protection (OCP), and the Office of the Chief Financial Officer (OCFO). We also reviewed NCUA policies and procedures related to NCUA's methodology for documenting estimated SIF losses and credit union failures, and interviewed headquarters and regional staff, as appropriate.

The results of our review disclosed NCUA management could strengthen its documenting of SIF estimated losses for specific credit union failures. Specifically, we determined E&I, OCFO, and AMAC documented different estimated SIF loss amounts throughout the year; however, we determined these differences are mostly attributable to timing differences and new information that is continually received, which causes the estimated SIF loss amounts to frequently change. In addition, we also determined each of these offices may not document SIF loss activity in a timely manner, and regional and central offices document losses into independent, nonintegrated systems. However, despite these offices having differing estimated loss amounts throughout the year due to timing, we also determined that these offices ensure that the estimated SIF loss amounts agree at year-end for financial statement reporting.

In addition, we determined NCUA management could strengthen its ability to capture basic credit union failure data. Specifically, we identified discrepancies between NCUA's regional and central offices when reporting the dates and types of credit union failures. This occurred because each office defines the timing of a failure in a different manner and uses independent, nonintegrated systems.

Although the estimated SIF loss amount of any particular failed credit union will change over time due to the realization of gains and losses from the disposal of items listed on the failed credit union's balance sheet, we believe NCUA could improve its process of documenting specific credit union failure data and related estimated SIF losses. Therefore, this report makes three recommendations to NCUA management related to

[1] We limited our scope to natural person credit unions.

revising internal procedures, conducting a feasibility study, and developing an agency-wide definition for credit union failure, all of which we believe will help correct the deficiencies discussed in this report.

We appreciate the cooperation and courtesies NCUA management and staff provided to us during this review.

BACKGROUND

Congress created the NCUSIF in 1970 to insure members' deposits in federally insured credit unions. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 permanently set the maximum share insurance amount at $250,000. NCUA administers the NCUSIF, which is backed by the full faith and credit of the United States Government, and covers all federally chartered and most state chartered credit unions.

The NCUSIF insured 7,338 credit unions as of December 31, 2010. As of July 31, 2012, the NCUSIF insured 6,942 credit unions, a decrease of 396. Unassisted mergers, which accounted for the majority of the decrease, do not generate losses to the NCUSIF. However, credit union failures such as assisted mergers, involuntary liquidations, and purchase and assumption agreements (P&A),[2] generally lead to losses to the NCUSIF. Twenty-nine of these failures occurred from January 1, 2011 to July 31, 2012, the scope period of our audit.

Share Insurance Fund Losses

A Share Insurance Fund loss is the total amount of money the NCUSIF must provide to an insured credit union and includes the estimated liquidation expenses needed stemming from liquidation. In addition, other actions can create future insurance losses such as an asset guarantee, or changes in the value of assets or liabilities retained by NCUA.

The NCUSIF maintains a liability and loss provision for insured credit unions. The amount recognized is the liability known with certainty (specific reserves); plus, an accrual for a contingent liability, based on probable failure and loss rates applied based on historical data (general reserve). In addition, regional offices and E&I each perform specific analysis on individual credit unions where failure is imminent. E&I inputs the results of this analysis into the Reserve Needs Report,[3] which E&I then provides to OCFO staff in order to record adjustments to the loss reserve in NCUA's accounting system.

Regional Offices

Regional offices estimate NCUSIF loss amounts upon approval by the Regional Director (RD) for a P&A, straight liquidation, or assisted merger. Although regional office staff uses ratio, credit, and collateral analysis to estimate the loss, they may also use solvency and liquidation cost worksheets. Regional office staff may also refine the estimated loss as the credit union moves towards insolvency. In some cases, regional

[2] A purchase and assumption (P&A) is a type of involuntary liquidation. For this review we separated P&As from other involuntary liquidations.
[3] E&I uses the Reserves Need Report to communicate the review and approval of changes to specific and general reserves to OCFO.

office staff may consult with NCUA’s AMAC regarding the valuation of estimated losses to obtain a more accurate estimate.

As credit unions continue to move towards insolvency, regional staff continue to supervise these troubled institutions until they are closed. At the time of liquidation, AMAC assumes responsibility for liquidating credit unions, including those with a P&A; however, regional offices continue to supervise merged credit unions throughout the merger process.

To document losses to the NCUSIF, regional office staff input estimated insurance losses for pending failures from high-risk credit unions into NCUA’s High Risk Pipeline application, which is within the Management Information System[4] (MIS). The High Risk Pipeline is an application that helps NCUA not only identify high-risk credit unions that have the potential to fail, but also reports the estimate of the amount of the potential loss. The application provides regional staff the ability to update a credit union’s estimated loss up to the point of liquidation.[5] Pertinent fields include:

- *Regional Rating (estimated date of resolution)* – an estimate of when a high risk credit union is expected to fail;
- *Estimated Loss Range* – a high loss estimate and actual case reserve requested (the region’s best estimate of the loss to the NCUSIF);
- *Guaranteed Line of Credit* – indicates whether a credit union has an outstanding line of credit;
- *Asset Guaranty/Indemnification* – indicates whether the credit union has an outstanding asset guaranty or indemnification.

Central Office & AMAC

In accordance with NCUA procedures for maintaining NCUSIF Reserves, E&I staff use information from the High Risk Pipeline application to report specific loss reserves for individual credit unions when a failure is certain in both timing and amount. However, in practice E&I staff uses various sources such as regional e-mails, regional concurrences, and AMAC memos. E&I staff also uses a statistical methodology to compute the general reserve for all other credit unions. After failure, AMAC officials may request adjustments to specific loss reserves for individually closed credit unions. To create the Reserve Needs Report, E&I staff uses the High Risk Pipeline application, request for concurrence for 208 assistance, management reports, 10-year Loss Report, current

[4] The Management Information System (MIS) is the central system used to store all federally insured credit union charter numbers, addresses, phone numbers, official names, credit union name changes, and significant event history, such as mergers and liquidations.
[5] For federally chartered credit unions, liquidation occurs when NCUA staff serves the liquidation order. For state chartered credit unions, liquidation occurs when the supervisory state authority appoints NCUA as the liquidating agent.

CAMEL information, specific external economic data, and AMAC's specific loss reserve requests.

OCFO staff uses the Reserve Needs Report to record insurance loss expense into the official books and records of the NCUSIF. The E&I Director must approve any request for additional reserves for losses. Changes are communicated to OCFO from E&I through the Reserves Needs Report. OCFO's NCUSIF staff record these changes in reserves for losses into NCUA's accounting system.[6] In addition, on a monthly basis OCFO staff tracks the cost of new failures for the sole purpose of reporting to the NCUA Board.

As previously mentioned, AMAC assumes responsibility of a credit union when a liquidation order is served on a federally chartered credit union or when NCUA accepts appointment as the liquidating agent for a federally insured state chartered credit union. AMAC staff produces monthly financial statements for each liquidated credit union. AMAC's estimated loss at liquidation may vary from the regional office's estimate due to additional information discovered after the regional office served the liquidation order. Once AMAC staff determines the estimated SIF loss amount effective at time of failure, they report the amount during the period when the estimated loss is calculated and reported to E&I. AMAC staff also records this amount into the credit union's general ledger *Gain/Loss at Commencement* account. However, this recording may not occur in the month of failure. Additionally, AMAC staff may request an adjustment to reserves for losses if their estimate differs from their original gain/loss at commencement amount. Further, AMAC staff records monthly realized gain/loss activity in the financial statements of the liquidated credit union and makes quarterly adjustments against any accrued income and expense that was originally included in the *Gain/Loss at Commencement* account.

Credit Union Failures

NCUA's annual report defines a failure as causing a loss to the NCUSIF, either through involuntary liquidation or assisted merger.

- Regional offices acknowledge credit union failures when the RD approves an assisted merger or an involuntary liquidation and P&A. Depending on the dollar amount of the estimated SIF loss, the RD may be required to receive authority from E&I or the NCUA Board per the delegations of authority.

  NCUA uses the MIS system and the GENISIS database[7] to document credit union failures. Specifically, regional staff initially input approved failure estimates into the High Risk Pipeline application within the MIS system, which the Office of Consumer Protection (OCP) later updates with the actual failure and loss

[6] NCUA uses the Delphi™ accounting system.
[7] NCUA's GENISIS database provides all NCUA offices with universal access to credit union structure information in the most automated format possible.

information for those credit unions that failed. OCP receives the merger or P&A liquidation GENISIS data entry form from the regional offices to log failures into the GENISIS database, which allows for the tracking of mergers, liquidations, and P&As, as well as other credit union structural information.

- OCFO obtains credit union failure information through e-mail or by telephone from either the regional offices or AMAC, and then manually enters this information into an informal system of record such as a Microsoft Excel® spreadsheet or a Microsoft Access® database. OCFO uses this system to assign a merger control number or P&A contract number.

  OCFO staff also produces reports regarding credit union failures for NCUA's Office of Public and Congressional Affairs (PACA), E&I, the NCUA Board, and for the public. These reports include listings of Involuntary Liquidations, P&As, and Assisted Mergers.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of this review was to determine NCUA's methodology for identifying and tracking credit union failures and losses to the NCUSIF. Specifically, we determined which group is responsible for establishing the initial estimated SIF loss amount, how changes are made to this amount, and by whom. To accomplish our objective we performed statistical analysis of NCUA's ability to account for specific credit union failures and the related SIF loss estimates of those failures at different points in time. We analyzed losses and failures at the time of occurrence, at year-end, and for the period ending July 31, 2012. The scope of our review covered all credit union failures occurring during calendar year 2011 as well as those occurring from January 1 through July 31, 2012. We reviewed and analyzed specific credit union failures and related estimated SIF loss data, as well as information obtained from NCUA's five regional offices, AMAC, E&I, OCP, and OCFO. We also reviewed NCUA policies and procedures, and interviewed Central Office and regional staff, as appropriate.

We conducted this review from August 2012 through October 2013, in accordance with generally accepted government auditing standards. We limited our scope to natural person credit union failures and their related losses to the NCUSIF, and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objective. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our review objectives.

RESULTS IN DETAIL

A. Share Insurance Fund Losses

NCUA's Process for Documenting Estimated SIF Loss Amounts Needs Strengthening

NCUA management could strengthen its process over estimating SIF loss amounts for specific failed credit unions. Specifically, we determined NCUA's regional offices and AMAC documented different estimated SIF loss amounts at different times that were ultimately used by E&I to update the Reserve Needs Report. In addition, we determined E&I needs to revise its procedures over estimating SIF loss amounts to reflect the other methods they use to determine estimated losses. We also determined each of these offices uses various nonintegrated systems to document their estimated losses. As a result, there is a risk that NCUA management might rely on an office's estimated SIF loss amount that is not the best estimate available at the time in terms of certainty of time and amount.

Differing Insurance Fund Loss Amounts at Time of Failure

As previously mentioned, NCUA's regional offices develop an estimated SIF loss amount to not only identify high-risk credit unions that have the potential to fail, but also to estimate SIF losses for credit unions that have regionally approved closure orders, i.e. involuntary liquidations, P&As, and assisted mergers. The regions may adjust their estimated loss amount up to the point of closure. At the time of closure, the regions pass responsibility to AMAC for liquidating all credit unions. However, we determined AMAC staff does not record the regional loss amount into its financial system for the failed credit union.

Following liquidation, AMAC staff performs independent analysis to determine the estimated SIF loss amounts for liquidated credit unions. This estimated SIF loss amount is effective as of the date of closure. Before AMAC staff can start developing their estimate, the credit union's financial statements must be completely closed and balanced. AMAC then establishes their initial estimated loss at the time of failure, which procedures allow up to 45 days to complete. AMAC staff then documents this amount in a memo to E&I and copies the appropriate region on the memo. Subsequently, AMAC staff records their estimated loss amount into the financial system of the credit union.

During our fieldwork, we determined that the dates we used for our test sample, January 1, 2011 through July 31, 2012, proved problematic because the Regional Offices and AMAC staff estimate SIF loss amounts for use in the Reserve Needs Report at different points in time. The regional offices provide an estimated SIF loss amount through the High Risk Pipeline prior to actual failure. The regional offices may or may not subsequently update this estimate.

AMAC staff determines their initial SIF loss estimate following liquidation and then adjusts all loss estimates quarterly, as needed. AMAC staff records loss data monthly for liquidated credit unions, but adjusts realized activity and makes adjustments for reserve for losses quarterly.

E&I staff provides a Reserve Needs Report monthly, unless there is insignificant activity. E&I staff reviews specific reserve needs monthly, but adjusts and reconciles the reserve for losses amount on a quarterly basis. Therefore, in the charts that follow in this report, it is possible that some of the differences we identified related to estimated SIF loss amounts could be due to timing differences since E&I staff reported quarterly loss numbers.

During calendar year 2011, NCUA supervised the closure of 17 credit unions that caused a loss to the SIF. One assisted merger agreement (Kunia), had an effective date in 2011; however, the merging credit unions did not consolidate the merger until 2012. Regional officials told us this was a timing issue because the RD had to approve the transaction prior to it occurring and needed concurrence from the Office of General Counsel and E&I. Table 1 (below) provides the amount of SIF losses and gains reported by regional offices, AMAC and E&I for liquidations, P&As, and assisted mergers for each of the 17 failed credit unions at the time of failure – and highlights the differences.

Table 1

	2011 Estimated SIF Loss Amounts at Time of Failure					
	Credit Union	**Region**	**Type of Failure ***	**Region** *(in dollars)*	**AMAC^** *(in dollars)*	**E&I** *(in dollars)*
1	NYC OTB	1	LIQ	0	76,638	(277,286)
2	BCT	1	P&A	(431,000)	0	(6,118,691)
3	Borinquen	2	LIQ	(3,400,000)	567,432	(5,090,191)
4	Oakland Municipal	2	P&A	(13,316,840)	0	(13,750,000)
5	Mission San Francisco	2	P&A	(1,250,000)	0	(1,295,477)
6	St James AME	2	P&A	(261,131)	0	(329,000)
7	South DeKalb	3	AM	(330,000)	N/A	(320,000)
8	Valued Members	3	P&A	(78,000)	0	(184,986)
9	Birmingham Financial	3	LIQ	(41,319)	(88,909)	(88,909)
10	Wisconsin Heights	4	P&A	(162,402)	(141,302)	(162,402)
11	Hmong American	4	LIQ	(1,800,819)	418,473	(1,621,253)
12	Vensure	5	LIQ	(39,043)	922,007	(300,000)
13	O.U.R	5	P&A	(3,736,385)	(3,710,000)	(3,710,000)
14	Kunia**	5	AM	(1,210,000)	N/A	(1,210,000)
15	Land of Enchantment	5	P&A	(1,075,018)	375,046	(1,050,000)
16	Family First	5	P&A	(21,500,000)	(15,472,741)	(21,500,000)
17	Utah Central	5	P&A	(500,000)	0	(1,755,000)

** LIQ = Liquidation; P&A = Purchase and Assumption; AM = Assisted Merger*
*** NCUA began the assisted merger of Kunia Federal Credit Union in 2011 and thus calculated an estimate of the loss during that year; however, NCUA did not complete the merger until January 2012.*
^ Amounts in this column are from AMAC's credit union financial reporting system – Asset Liquidation Management System (ALMS), the Gain/Loss at Commencement line item, which reflects liquidation activity at the time of failure.

As shown in Table 1 above, there were five liquidations in 2011 and none of the regional offices' estimated SIF loss amounts associated with those five liquidations matched the estimated SIF loss amounts reported by AMAC or E&I. In addition, four of the five estimated SIF loss amounts documented by E&I differed from the estimates recorded by AMAC in ALMS.

Table 1 also shows there were ten P&As in 2011, and again we determined none of the estimated SIF loss amounts reported to the OIG by the regional offices matched the estimated loss amounts recorded by AMAC. However, the regional offices' estimated SIF loss amounts did agree with E&I's estimated loss amounts in two cases (Wisconsin Heights and Family First). For six of ten P&As that occurred in 2011, AMAC did not report any estimated SIF loss amounts at commencement in ALMS during the month the actual failures took place. NCUA management told the OIG that AMAC's ability to complete their loss at commencement review during the same calendar month as the credit union's failure, depended on how early in the month the liquidation occurred, the complexity of the liquidation, and AMAC's accounting process, which closes each accounting period on the last business day of the month. Therefore, we believe it is reasonable that AMAC would not necessarily have an estimated SIF loss amount at commencement recorded in the month of failure in ALMS. However, AMAC reports to E&I, via memo, their estimated loss at time of failure when they complete their analysis. Additionally, because AMAC does not work with assisted mergers, they do not report any subsequent estimated SIF loss amounts for those types of credit union failures. As for the two assisted mergers in 2011, the regional offices' estimated SIF loss amounts agreed with E&I in one case, and in the other case, E&I advised the OIG they had erred in their estimated SIF loss reserve amount.

The scope of our review also covered the period from January 1, 2012 through July 31, 2012 wherein NCUA supervised the closure of twelve credit unions that caused a loss to the SIF. As shown in Table 2 (below), the regional offices, AMAC, and E&I reported to the OIG different estimated SIF loss amounts at the time of failure for all six P&As that occurred during the first seven months of 2012. As noted above, AMAC reports to E&I, via memo, their estimated loss at time of failure when they complete their analysis. For one P&A (People for People), AMAC recorded in ALMS an estimated SIF loss of $290,219 in the month of failure. E&I, however, did not document a specific reserve for this credit union during the month of failure, but did document this same estimated SIF loss amount two months later. E&I staff advised the OIG that AMAC did not inform them of the estimated SIF loss amount in a timely manner; however, they noted a $200,000 maximum exposure in the Reserve Needs Report in the month of failure.

Table 2

January – July 2012 Estimated SIF Loss Amounts at Time of Failure						
Credit Union		Region	Type of* Failure	Region *(in dollars)*	AMAC^ *(in dollars)*	E&I *(in dollars)*
1	Eastern New York	1	PA	(2,694,560)	0	(3,600,000)
2	People for People	2	PA	(79,718)	(290,219)	0
3	C.D.	2	AM	(6,500,000)	N/A	(6,500,000)
4	California. Pacific	2	AM	(2,500,000)	N/A	(2,500,000)
5	Telesis Community	3	PA	(254,658,136)	0	(72,300,000)
6	Shepherd's	3	LIQ	Not listed	0	0
7	Rocky River	3	UAM	(1,406,451)	N/A	N/A
8	Wausau Postal	4	PA	(140,000)	0	(166,927)
9	A M Community	4	PA	(62,000)	0	(77,107)
10	H.B.E	4	AM	(332,061)	N/A	(332,061)
11	H.H.A	4	AM	(50,254)	N/A	0
12	Branch 825 NALC	4	AM	(229,650)	N/A	(229,650)
13	Saguache County	5	PA	(8,100,000)	0	(8,092,057)

** LIQ = Liquidation; P&A = Purchase and Assumption; AM = Assisted Merger; UAM = Unassisted Merger*
^ Amounts in this column are from AMAC's ALMS, the Gain/Loss at Commencement line item, which reflects liquidation activity at the time of failure.

As shown in Table 2 above, AMAC did not record a loss in ALMS at the time of failure for the one liquidation (Shepherds) occurring during this period. Region III initially did not list Shepherds as a failure with a loss; however, after OIG inquiry, Region III subsequently listed Shepherds as a liquidation with a loss of $602,060. E&I had listed that loss amount in the month following the failure. Note, Table 2 shows thirteen credit union failures; however, Rocky River, which was initially listed as a failure by Region III, was subsequently determined not to be a failure causing a loss to the SIF.

Table 2 also shows that for the assisted mergers occurring from January to July 2012, the regional offices' estimated SIF loss amounts agreed with E&I's Reserve Needs Report in four of five cases. In the one case that did not match (H.H.A.), we determined E&I listed the estimated SIF loss amount in the following month's Reserve Needs Report. In addition, among the seven credit union failures occurring through July 2012, AMAC recorded only one estimated SIF loss amount in ALMS at the time of failure. As previously mentioned, AMAC may not always be able to determine an estimated SIF loss amount at commencement in the month of failure due to timing issues, and the complexity of the liquidation.

We identified the following reasons to explain why the estimated SIF loss amounts differ among the various offices:

- Each office estimates losses in a different manner;
- Offices do not document loss activity in a timely manner; and
- Regional and Central Office staff document losses into different stand-alone systems.

<u>Losses Estimated Differently</u>

We found NCUA regional offices, AMAC, and E&I estimate a loss to the SIF differently in regards to the timing of the loss. For example, we learned during our review the following as it relates to when each group estimates SIF loss amounts:

- Regional offices estimate SIF losses at the time the regional director approves taking "failure" actions. The regional offices' estimated SIF loss amounts are based on the failed credit union's latest available balance sheet, and do not include estimated liquidation expenses. Regional office staff may update estimated losses up to the closure date.

- When fiscal responsibility shifts from the regional offices to AMAC (date of liquidation), AMAC performs an analysis of the estimated SIF loss amount effective at the failure commencement date. AMAC does not record or report this loss estimate in ALMS until such analysis is completed. AMAC officials told the OIG the estimated SIF loss amounts recorded by AMAC, at the time of closure, might not be the same as identified by the regional offices due to additional information discovered after NCUA serves the liquidation order. AMAC officials also advised the OIG that during the liquidation process, they propose reserve adjustments to E&I based on their analysis of the failed credit union's balance sheet and estimated liquidation expenses.

- E&I documents specific reserves for losses on institutions where failure is imminent in the Reserve Needs Report. Regional office staff makes a request for these reserves prior to closure. AMAC may request additional reserves for losses, after closure. We learned during our review that the Reserve Needs Report may use both of these amounts. E&I communicates these specific reserves for losses to OCFO through the Reserve Needs Report.

- OCFO records reserves for losses from the Reserve Needs Report and records AMAC's realized gain/loss activity.

Loss Activity Documented at Different Times

For twelve of the 22 liquidated credit unions reviewed, including P&As, AMAC did not record any estimated SIF loss amount at commencement in ALMS during the month the credit union failed. AMAC advised the OIG the delays were due to the timing and complexity of the balance sheet analysis they conduct as well as the development of the estimated liquidation expenses.
For the estimated SIF loss amounts not timely documented by E&I, we determined E&I staff relies upon the other offices to notify them of the estimated SIF losses at the time of failure. We confirmed this in the 2012 credit union failures of People for People, Shepherds, and H.H.A.

Stand Alone Systems Used to Document Losses

NCUA regional offices, AMAC, OFCO, and E&I utilize four independent data systems to document and retain SIF loss estimates for agency use. Specifically, we determined:

- Regional staff input data into the High Risk Pipeline application.

- AMAC records estimated SIF loss amounts at commencement and realized loss activity for each credit union through ALMS. AMAC adjusts realized activity and estimated losses quarterly.

- In accordance with written procedures, E&I staff use the High Risk Pipeline data and manually enter estimated SIF loss amount information into a Microsoft Excel® spreadsheet, which contains the Reserve Needs Report. In practice, we learned E&I staff might also estimate SIF loss amounts using other sources, which includes e-mail, regional concurrences, or AMAC memos of estimated reserves. E&I staff uses the information in the High Risk Pipeline, historical loss data from OCFO, loss projections and information from AMAC, and then transmits adjustments to OCFO via the Reserve Needs report. E&I staff documents estimated loss adjustments quarterly.

- OCFO manually enters the journal entry/estimated SIF loss amount into NCUA's Delphi accounting system from the Reserve Needs Report.

The estimated SIF loss amount of a particular failed credit union might change over time due to the realization of gains and losses from the disposal of asset, liability, and equity accounts listed on the failed credit union's balance sheet. Any changes must then be communicated to E&I staff for capture on the Reserve Needs Report and reported to OCFO for any adjustments. We believe that without a more consistent agency-wide methodology for documenting estimated SIF loss amounts, NCUA and its stakeholders may rely on estimated loss amounts that are not the best estimates at the time. Therefore, we are making the following recommendations to NCUA management.

Recommendations

We recommend NCUA management:

1. Formalize and update existing internal procedures used for maintaining the National Credit Union Share Insurance Fund's reserves to ensure procedures reflect current practices for recording estimated National Credit Union Share Insurance Fund loss amounts, the yearly number and dates of credit union failures; and the systems used to record these events.

Management Response

Management agreed and plans to review the flows of information, the related policies, and update such to ensure procedures reflect current processes and the systems used. In addition, management indicated they would assess whether the consistency of information can be improved at timeframes other than year-end closing (e.g., month-end, quarter-end).

OIG Response

We concur with management's planned actions.

2. Conduct a feasibility study to conclude the most economical and efficient method to capture and share estimated National Credit Union Share Insurance Fund loss amount data among the various offices that use and rely upon this data for reporting to key internal and external stakeholders. Two possible options include: (1) determine the feasibility of integrating or providing automated interfaces between the various systems currently in use by NCUA offices to record the estimated National Credit Union Share Insurance Fund loss amounts. This would include integrating such systems as the High Risk Pipeline, Reserve

Needs Report, AMAC's Asset Liquidation Management System (credit union financial system), and the Delphi financial management system. (2) determine the feasibility of creating a new centralized National Credit Union Share Insurance Fund estimated loss database for use by all offices to track and record loss estimates and failure data.

Management Response

Management agreed and plans to have the Office of the Chief Financial Officer, the Office of Examination and Insurance, and the Asset Management & Assistance Center jointly review the two options as well as their current processes to formalize and update internal procedures for calculating and reporting loss estimates and cost of failures.

OIG Response

We concur with management's planned actions.

<u>Insurance Fund Losses at Period End</u>

As discussed in the preceding section, the estimated SIF loss amounts differed significantly among various offices when viewed in the context of loss amounts calculated at the time of a credit union's failure. However, we determined that when viewed in the context of a period ending date, E&I, OCFO, and AMAC generally agreed with the same estimated SIF loss and gain amounts as of December 31, 2011, the fiscal year-end. Table 3 (below) shows the losses and gains to the SIF for failures occurring during calendar year 2011, by office, at year-end.

Table 3

2011 Estimated SIF Losses at Year-End						
Credit Union		Region	Type of Failure	E&I *(in dollars)*	OCFO *(in dollars)*	AMAC *(in dollars)*
1	NYC OTB	1	LIQ	(727,019)	(727,019)	(727,019)
2	BCT	1	PA	(5,649,450)	(5,650,742)	(5,650,742)
3	Borinquen	2	LIQ	(5,385,800)	(5,385,800)	(5,385,800)
4	Oakland Municipal	2	PA	(12,981,019)	(12,981,019)	(12,981,019)
5	Mission San Francisco	2	PA	(1,343,815)	(1,343,815)	(1,343,815)
6	St James AME	2	PA	(358,852)	(358,852)	(358,852)
7	South DeKalb	3	AM	(320,000)	(330,000)	N/A
8	Valued Members	3	PA	(239,937)	(239,937)	(239,937)
9	Birmingham Financial	3	LIQ	(88,909)	(88,909)	(88,909)
10	Wisconsin Heights	4	PA	(162,605)	(162,605)	(162,605)
11	Hmong American	4	LIQ	(1,688,454)	(1,688,454)	(1,688,454)
12	Vensure	5	LIQ	(28,673)	(28,673)	(28,673)
13	O.U.R	5	PA	(3,710,000)	(3,710,000)	(3,710,000)
14	Kunia*	5	AM	(1,210,000)	(1,210,000)	N/A
15	Land of Enchantment	5	PA	46,841	46,841	46,841
16	Family First	5	PA	(20,957,662)	(20,957,662)	(20,957,662)
17	Utah Central	5	PA	(1,340,472)	(1,340,472)	(1,340,472)

LIQ = Liquidation; P&A = Purchase and Assumption; AM = Assisted Merger

* *As previously noted NCUA began the assisted merger of Kunia Federal Credit Union in 2011 but did not complete it until January 2012.*

As shown in Table 3 above, there were no discrepancies among the estimated SIF loss amounts reported by OCFO and AMAC at year-end 2011. We believe this is primarily due to the quarterly reconciliation process between offices. However, E&I differed on two credit unions, BCT and South DeKalb in immaterial amounts. According to E&I, the amount recorded for BCT agreed to AMAC's reserve memo of December 15, 2011, and the amount recorded for South DeKalb, E&I posted in error.

We also requested from E&I, OFCO, and AMAC, all SIF losses for the period from January 1, 2012 through July 31, 2012. As shown in Table 4 below, OCFO reported to the OIG, SIF loss amounts as of July 31, 2012 that matched the estimated loss amounts for all liquidations and P&As as reported in AMAC's financial reporting system. However, E&I reported to the OIG their SIF loss amounts as of June 30, 2012 as opposed to the requested date of July 31, 2012. E&I staff receives updated loss figures for liquidations, P&As, and assisted mergers from OCFO quarterly, not monthly. During fieldwork, we determined that the dates used for our test sample – January 1, 2011 through July 31, 2012 – proved problematic because the regional offices enter losses into the High Risk Pipeline on a monthly basis. However, E&I and OCFO reconcile and adjust the amounts for the Reserve Needs Report on a quarterly basis. AMAC also reconciles with OCFO on a quarterly basis. When we inquired with E&I and AMAC as to why they do not reconcile the Reserve Needs Report on a monthly basis, they explained they did not have the resources to perform this task monthly.

Table 4

	January-July 2012 Estimated SIF Losses as of July 31, 2012					
	Credit Union	**Region**	**Type of Failure**	**E&I** *(in dollars)*	**OCFO** *(in dollars)*	**AMAC** *(in dollars)*
1	Eastern NY	1	PA	(3,571,813)	(3,592,399)	(3,592,399)
2	People for People	2	PA	(270,219)	(271,092)	(271,092)
3	C.D.	2	AM	(6,500,000)	(6,500,000)	N/A
4	California Pacific	2	AM	(2,500,000)	(2,500,000)	N/A
5	Telesis Community	3	PA	(72,000,000)	(71,166,737)	(71,166,737)
6	Shepherd's	3	LIQ	(602,059)	(603,615)	(603,615)
7	Wausau Postal	4	PA	(166,927)	(167,003)	(167,003)
8	A M Community	4	PA	(77,107)	0	0
9	H.B.E	4	AM	(332,061)	(332,061)	N/A
10	H.H.A	4	AM	(50,254)	(50,254)	N/A
11	Branch 825 NALC	4	AM	(229,650)	(229,650)	N/A
12	Saguache County	5	PA	(7,462,519)	(7,474,061)	(7,474,061)

LIQ = Liquidation; P&A = Purchase and Assumption; AM = Assisted Merger

As shown in Table 4 above, OCFO's and AMAC's estimated SIF loss amounts for all liquidations and P&As were the same as of July 31, 2012. However, in one P&A (AM Community), which failed in July 2012, neither OCFO nor AMAC recorded an estimated loss in that month. However, they both recorded the AM Community reserve for loss in August 2012.

B. Credit Union Failure Data

Capturing Credit Union Failure Data Needs Strengthening

NCUA management needs to strengthen its ability to capture failed credit union data. Specifically, we identified discrepancies between the regional offices, E&I, OFCO, and OCP when reporting to the OIG on the dates of credit union failures, and one discrepancy when reporting on the types of credit union failures. Our review identified discrepancies with reported dates due to NCUA's lack of a clear definition of when a failure occurs. As a result, each of these groups uses a different definition to define when they believe is the actual date of failure. We also identified one instance where one group incorrectly identified the type of failure. As a result of these weaknesses, we believe NCUA may report inaccurate data regarding credit union failure dates and/or types of credit union failures.

Inconsistent Reported Failure Dates

We determined that the failure dates reported to the OIG by each of the different NCUA offices varied significantly. Table 5 (below) shows the failure date reported by each office for credit union failures occurring from January 1 through December 31, 2011:

Table 5

	2011 Actual and Reported Failure Dates						
	Credit Union	**Region**	**Actual**	**Region**	**E&I**	**OCFO**	**OCP**
1	NYC OTB	1	2/23/11	2/16/11	2/23/11	2/23/11	2/16/11
2	BCT	1	11/30/11	11/30/11	11/30/11	11/30/11	11/30/11
3	Borinquen	2	7/8/11	7/8/11	7/8/11	7/8/11	7/8/11
4	Oakland Municipal	2	2/4/11	2/4/11	2/4/11	2/4/11	2/4/11
5	Mission San Francisco	2	4/8/11	4/8/11	4/8/11	4/8/11	4/8/11
6	St James AME	2	6/24/11	6/24/11	6/24/11	6/24/11	12/1/11
7	South DeKalb	3	5/1/11	5/1/11	5/1/11	5/1/11	5/1/11
8	Valued Members	3	5/31/11	5/31/11	5/31/11	5/31/11	7/1/11
9	Birmingham Financial	3	12/16/11	12/31/11	12/19/11	12/16/11	12/15/11
10	Wisconsin Heights	4	3/4/11	3/4/11	3/4/11	3/4/11	3/4/11
11	Hmong American	4	5/18/11	6/15/11	5/18/11	5/17/11	6/15/11
12	Vensure	5	7/11/11	7/11/11	7/11/11	7/11/11	7/26/11
13	O.U.R	5	12/2/11	12/2/11	12/2/11	12/2/11	12/2/11
14	Kunia	5	12/16/11	12/16/11	1/1/12	1/6/12	1/1/12
15	Land of Enchantment	5	3/7/11	3/7/11	3/7/11	3/7/11	3/11/11
16	Family First	5	2/15/11	2/15/11	2/15/11	2/11/11	3/2/11
17	Utah Central	5	4/29/11	4/29/11	4/29/11	4/29/11	4/29/11

As shown above in Table 5, NCUA regional and central offices differed on the actual date of failure for nine of the 17[8] credit unions that failed in 2011. Table 5 also identifies the following discrepancies, by office:

- Regional Offices differed in three of 17 failures. Upon subsequent inquiry, the regional offices advised the OIG that the failure dates provided for the three different responses were in error.

- E&I differed in two of 17 failures. E&I advised the OIG they used a failure date from a press release in one case and the actual assisted merger consolidation date in the other.

- OCFO differed in three of 17 failures. OCFO advised the OIG they obtained failure dates through regional or AMAC telephone and/or e-mail notification.

- OCP differed in nine of 17 failures. OCP advised the OIG they provided dates obtained from NCUA's Genisis system, which uses regionally input data.

[8] As previously mentioned, Kunia Federal Credit Union was listed as failing by the region in 2011 with an assisted merger effective date of December 16, 2011, however Kunia's assisted merger was consummated in 2012.

Table 6 (below) provides the failure date reported to the OIG by each office for credit union failures occurring from January 1 through July 31, 2012:

Table 6

	January – July 2012 Actual and Reported Failure Dates						
	Credit Union	**Region**	**Actual**	**Region**	**E&I**	**OCFO**	**OCP**
1	Eastern New York	1	1/27/12	1/27/12	1/27/12	1/27/12	1/27/12
2	People for People	*2*	2/16/12	2/16/12	2/17/12	2/27/12	2/9/12
3	C.D.	*2*	5/24/12	5/31/12	5/31/12	5/24/12	5/31/12
4	California Pacific	*2*	5/24/12	5/31/12	5/31/12	5/24/12	5/31/12
5	Telesis Community	3	5/31/12	5/31/12	5/31/12	5/31/12	6/1/12
6	Shepherd's	3	3/26/12	Not Reported	3/26/12	3/26/12	4/9/12
7	Wausau Postal	4	5/18/12	5/18/12	5/18/12	5/18/12	5/18/12
8	A M Community	4	7/31/12	7/31/12	8/1/12	7/31/12	7/31/12
9	H.B.E	4	2/7/12	2/7/12	2/6/12	2/26/12	2/29/12
10	H.H.A	4	3/31/12	3/31/12	3/31/12	3/31/12	3/31/12
11	Branch 825 NALC	4	8/1/12	6/30/12	6/30/12	6/13/12	8/1/12
12	Saguache County	5	3/23/12	3/23/12	3/23/12	3/22/12	2/16/12
13	Rocky River	3	N/A	5/1/12	N/A	N/A	N/A

As shown in Table 6 above, the light red highlighted areas indicate discrepancies from the actual failure dates. For failures occurring from January 1 through July 31, 2012, NCUA offices differed on what was the actual date of failure for nine of 12 credit unions (not including Rocky River). Region III initially listed Rocky River as a failure; however, it was actually an unassisted merger. Region III also initially did not list Shepherd's as a failure, when in fact it failed in March 2012. Table 6 also identifies the following discrepancies, by office:

- Regional Offices differed in four of 12 failures. The regional offices told the OIG that for the four failures that differed, three were assisted mergers and that the regional offices provided the OIG with the dates of actual consolidation. The other failure was an unreported liquidation, which the region subsequently acknowledged.

- E&I differed in six of 12 failures. E&I staff told the OIG they use a variety of sources of information and then make a determination as to which source is the best to use.

- OCFO differed in four of 12 failures. OCFO staff told the OIG they obtain failure dates via regional or AMAC telephone and/or e-mail notification.

- OCP differed in seven of 12 failures. OCP told the OIG they used the dates they obtained from NCUA's Genisis system, which uses regionally input data.

NCUA management told the OIG that failure dates can, and do, change because of delays caused by data processing issues. In addition, NCUA management stated that liquidation dates can be revised depending on staffing availability or other unforeseen issues.

We believe the primary cause for the inconsistent failure dates reported by the regions, E&I, OFCO, and OCP is due to NCUA's lack of a clear definition as to when a credit union failure actually occurs. As a result, each of the aforementioned groups uses what they believe to be the date of failure. Because these groups use independent, nonintegrated systems to record credit union failure dates, when NCUA extracts information from these systems for internal or public stakeholder use, NCUA management cannot be certain that the information provided is accurate. Sound business practices call for having a consistent methodology to accurately record and report on information used by internal and external stakeholders. We could not identify a regulatory or statutory provision that defines what NCUA considers an actual credit union date of failure. Therefore, we are making the following recommendation.

Recommendation

We recommend NCUA management:

3. Develop an agency-wide definition for the term "failure date" for both federal and state chartered credit union involuntary liquidations, purchase and assumptions, and assisted mergers to ensure agency-wide consistency when reporting on when a credit union is actually considered to have failed.

Management Response

Management agreed and plans to review and revise common terms, such as "failure date," to ensure that definitions are precise, understandable, and promote data consistency across the agency.

OIG Response

We concur with management's planned actions.

Inconsistent Reporting on Types of Credit Union Failures

During 2011, we determined NCUA regional and central offices differed when reporting to the OIG on credit union closures by the type of failure. Our review of closure documentation disclosed 17 credit union failures consisting of five involuntary liquidations, ten P&As, and two assisted mergers. The regional offices and OCFO agreed on the type of failures for 15 of the 17 credit union closures. See Table 7 (below) for details of the actual closure type and the regional offices' and OCFO's reported type of failure.

Table 7

2011 Actual Closure Type						
Credit Union		Region Location	Actual Type	Region	OCFO
1	NYC OTB	1	LIQ	LIQ	LIQ
2	BCT	1	PA	PA	PA
3	Borinquen	2	LIQ	LIQ	LIQ
4	Oakland Municipal	2	PA	PA	PA
5	Mission San Francisco	2	PA	PA	PA
6	St James AME	2	PA	PA	PA
7	South DeKalb	3	AM	AM	AM
8	Valued Members	3	PA	PA	PA
9	Birmingham Financial	3	PA	PA	PA
10	Wisconsin Heights	4	PA	PA	PA
11	Hmong American	4	LIQ	LIQ	LIQ
12	Vensure	5	LIQ	LIQ	LIQ
13	O.U.R	5	PA	PA	PA
14	Kunia	5	AM	AM	Not Reported
15	Land of Enchantment	5	PA	PA	PA
16	Family First	5	PA	PA	PA
17	Utah Central	5	PA	PA	LIQ

LIQ = Liquidation; P&A = Purchase and Assumption; AM = Assisted Merger

As shown in Table 7 above, we identified two exceptions as highlighted in light red. The following are details of the exceptions:

- Region V listed Kunia as an assisted merger in 2011 with December 16, 2011 as the effective date of the assisted merger agreement; however, merging credit unions consolidated the assisted merger in 2012; therefore OCFO did not report the assisted merger in 2011; and

- OFCO listed the failure of Utah Central as a liquidation; however, we determined the actual failure type was a P&A. OCFO staff noted they listed it as a liquidation and not a P&A because there was no cash payout.

During 2011, we determined the regional offices, E&I, and OCFO each reported to the OIG that there were 16 failures, whereas OCP reported 17.[9] Table 8 (below) provides the number of failures reported by each office during 2011, by type:

[9] As previously noted, Kunia Credit Union was listed as a failure during both 2011 and 2012.

Table 8

2011 Number of Reported Failures – by Type									
Type of Failure	**Region I**	**Region II**	**Region III**	**Region IV**	**Region V**	**Region Totals**	**E&I**	**OCFO**	**OCP**
Involuntary Liquidation	1	0	0	1	1	3	4	5	4
Purchase & Assumption	1	2	2	1	5	11	11	10	11
Assisted Merger	0	0	1	0	1	2	1	1	2
Totals	2	2	3	2	7	16	16	16	17

As shown in Table 8 above, E&I, OCFO, and OCP each reported to the OIG more involuntary liquidations than did the regional offices. OCFO reported ten P&As, whereas the regional offices, E&I, and OCP each reported 11. In addition, the regional offices and OCP reported one more assisted merger, two (2), than did E&I and OCFO (1).

For the period from January 1, 2012 to July 31, 2012, the regional offices, E&I, OCFO, and OCP each reported 13 credit union failures. Table 9 (below) provides the number and type of credit union failures that occurred from January 1 through July 31, 2012:

Table 9

January 1, 2012 – July 31, 2012 Number of Reported Failures – by Type									
Type of Failure	**Region I**	**Region II**	**Region III**	**Region IV**	**Region V**	**Region Totals**	**E&I**	**OCFO**	**OCP**
Involuntary Liquidation	0	1	2	0	0	3	1	1	3
Purchase & Assumption	1		0	2	1	4	6	6	5
Assisted Merger	0	2	0	3	1	6	6	6	5
Total	1	3	2	5	2	13	13	13	13

As shown in Table 9 above, the regional offices and OCP each reported three involuntary liquidations, whereas E&I and OCFO each reported one. In addition, E&I and OCFO each reported six P&As; however, the regional offices reported four and OCP reported five. Finally, the regional offices, E&I, and OCFO each reported six assisted mergers, whereas OCP reported five.

During the period from January 1, 2012 through July 31, 2012, we determined OCFO and three of the five regional offices accurately recorded credit union closures by the type of failure. Our review of actual closure documentation disclosed 12 credit union failures consisting of one liquidation, six P&As, and five assisted mergers. In addition, we determined one closure (Rocky River), which was actually an unassisted merger; however, Region III listed it as an assisted merger and OFCO did not record any type of loss for this failure.[10] We also determined Region III did not list the failure of Shepherd's Credit Union, and Region V listed the failure of Kunia as an assisted merger in 2011 although the actual consolidation occurred in 2012. Despite these differences, the regional offices and OCFO agreed on the type of failures for 11 of the 12 credit union closures. See Table 10 (below) for details of the actual closure type and the regional offices' and OCFO's reported type of failure, with discrepancies highlighted in light red.

Table 10

January 1, 2012 – July 31, 2012 Actual Closure Type					
Credit Union		Region	Actual	Region	OCFO
1	Eastern NY	1	PA	PA	PA
2	People for People	2	PA	PA	PA
3	C.D.	2	AM	AM	AM
4	California Pacific	2	AM	AM	AM
5	Telesis Community	3	PA	PA	PA
6	Shepherd's	3	LIQ	Not Listed	LIQ
7	Wausau Postal	4	PA	PA	PA
8	A M Community	4	PA	PA	PA
9	H.B.E	4	AM	AM	AM
10	H.H.A	4	AM	AM	AM
11	Branch 825 NALC	4	AM	AM	AM
12	Saguache County	5	PA	PA	PA

LIQ = Liquidation; P&A = Purchase and Assumption; AM = Assisted Merger

Recommendation

For the issues raised above related to NCUA's inability to accurately capture data related to the types of credit union failures, we believe if NCUA management takes action to address Recommendations 1, 2, and 3 in this report, these issues would be adequately addressed; therefore, we are making no specific recommendations to correct the identified weaknesses at this time.

[10] We included Rocky River School Employees FCU in Table 6.

APPENDIX A – NCUA Management Response

National Credit Union Administration

OCFO/MW:jcm
SSIC 1920

SENT BY E-MAIL

TO: Inspector General Jim Hagen

FROM: Executive Director Mark Treichel Mark Treichel

SUBJ: Agency Comments on Process for Documenting Credit Union Failures and Their Associated Share Insurance Fund Losses

DATE: October 24, 2013

This memorandum responds to your request for comment on the Process for Documenting Credit Union Failures and Their Associated Share Insurance Fund Losses. Thank you for the opportunity to review and comment on your report's findings and recommendations. We concur with the recommendations. Below is an outline of our plan of action.

OIG Report Recommendation #1
Formalize and update existing internal procedures used for maintaining the National Credit Union Share Insurance Fund's reserves to ensure procedures reflect current practices for recording estimated National Credit Union Share Insurance Fund loss amounts, the yearly number and dates of credit union failures; and the systems used to record these events.

Response:
The Office of Examination and Insurance will review and update policies and procedures to reflect current processes and the systems used.

OIG Report Recommendation #2
Conduct a feasibility study to conclude the most economical and efficient method to capture and share estimated National Credit Union Share Insurance Fund loss amount data among the various offices that use and rely upon this data for reporting to key internal and external stakeholders. Two possible options include:

Option 1 would determine the feasibility of integrating or providing automated interfaces between the various systems currently in use by NCUA offices to record the estimated National Credit Union Share Insurance Fund loss amounts. This would include integrating such systems as the High Risk Pipeline, Reserve Needs Report, AMAC's Asset Liquidation Management System (credit union financial system), and the Delphi financial management system.

Option 2 would be to determine the feasibility of creating a new centralized National Credit Union Share Insurance Fund estimated loss database for use by all offices to track and record loss estimates and failure data.

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Response:
For the last ten years, the number of involuntary liquidations averaged 13 per year and the number of assisted mergers averaged 6 per year. This low volume may not lend itself to cost efficiencies in creating and maintaining automated processes or a centralized data repository. The Office of the Chief Financial Officer, the Office of Examination and Insurance, and the Asset Management & Assistance Center will jointly review the two options presented in your report as well as our current processes to formalize and update internal procedures for calculating and reporting loss estimates and cost of failures.

OIG Report Recommendation #3
Develop an agency-wide definition for the term "failure date" for both federal and state chartered credit union involuntary liquidations, purchase and assumptions, and assisted mergers to ensure agency-wide consistency when reporting on when a credit union is actually considered to have failed.

Response:
As part of updating policies related to Recommendation #1, we will review and revise common terms, such as "failure date," to ensure that definitions are precise and understandable.

If you have any questions, please do not hesitate to contact my office.

cc: DED Kutchey