

NATIONAL CREDIT UNION ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

**YEAR 2000
CREDIT UNION PROGRESS
IN MEETING RENOVATION MILESTONE**

OIG-997 June 15, 1999



Frank Thomas

**FRANK THOMAS
INSPECTOR GENERAL**

TABLE OF CONTENTS

	PAGE
INTRODUCTION	1
BACKGROUND	1
OBJECTIVES	2
SCOPE AND METHODOLOGY	2
OBSERVATIONS	3
Credit Union Renovation Phase Status	3
Credit Union Quarterly Y2K Reports	4
Risk Ratings and Problem Identification	4
MATTERS FOR CONSIDERATION	5

Introduction

This is the third of the Office of Inspector General's (OIG) series of reports addressing the Year 2000 (Y2K) computer problem as it relates to the National Credit Union Administration (NCUA) and federally insured credit unions (FICUs). This report addresses the OIG review of federally insured credit unions' progress in meeting the renovation phase milestone date established by NCUA.

Because of the time critical nature of the Y2K problem, and in order to provide the NCUA Board with timely information, we are not making formal recommendations or asking for a written response. Rather, we are offering certain suggested actions as matters for consideration by the NCUA Board and agency management in this management report.

Other Y2K reviews in process include: credit union vendor status; the progress of high risk credit unions; and credit union liquidity plans.

Background

The NCUA, in addressing potential Y2K problems in FICU information systems, adopted milestone dates for credit unions to accomplish specific Y2K tasks. The purpose of the milestone dates was to ensure credit union information systems were ready to function in a timely manner. Benchmark milestone dates were developed to address awareness, assessment, renovation, validation/testing, and implementation phases. In early 1998, NCUA established a policy of providing waivers or extensions to the milestone dates. Waivers and extensions have been granted for individual credit unions and blanket waivers for some credit unions with common information system vendors. If credit union remediation efforts were not performed in a timely manner in accordance with the milestone dates and waivers, the NCUA could take administrative action¹ against the credit union because of unsafe and unsound practices.

Our first Y2K review (*Year 2000 Waiver Process Review, OIG Report Number 992*) focused on credit unions that requested waivers and extensions of milestone dates primarily for renovation. The main reasons for the waivers and extensions were due to credit union data processing system conversions and vendor inability to meet the milestone dates. Most credit unions were reported by NCUA to be making satisfactory progress and had not requested waivers or extensions to the milestone dates.

NCUA's milestone for completion of the renovation phase was January 31, 1999. We were concerned that there may be FICUs that had not met the milestone and were not accounted for by waiver or administrative action. A credit union's failure to meet the renovation phase milestone without a waiver or administrative action in place could result in NCUA having a false picture of credit union Y2K status.

¹ Administrative actions are defined as any action taken by NCUA to compel a credit union to take measures to correct identified problems such as a regional director letter or preliminary warning letter to compel action.

Objectives

Our objectives were: (a) to evaluate the progress of credit unions in meeting the January 31, 1999 Y2K milestone for completion of the renovation phase; and (b) to determine if the December 31, 1998 quarterly reports filed by the credit unions with NCUA are reporting accurate results of the renovation phase.

Scope and Methodology

We reviewed documentation for a sample of credit unions without waivers from two of the six regions to determine if they had complied with the January 31, 1999 Y2K milestone date for completion of the renovation phase. We also reviewed the sample of credit unions to determine if the December 31, 1998 quarterly reports filed by the credit unions with NCUA reported accurate results for the renovation phase. The review was performed in Regions II and III and included thirty-three FICUs in three asset strata sizes of less than \$10 million; \$10-50 million; and greater than \$50 million. Our review began in February 1999 and the fieldwork was completed in April 1999. Because of the limited review scope and our desire to provide NCUA management with timely information, we followed the President's Council on Integrity and Efficiency Quality Standards for Inspections with the exception of the standards for fraud and other illegal acts and follow-up.

Our review was designed to answer the following questions:

- Was there clear and adequate guidance to staff and credit unions to resolve Y2K problems and if the examiner discussed the Y2K situation at the credit union;
- What is credit union current status regarding Renovation/Testing/Implementation phases;
- Did the last on-site contact identify Y2K problems including renovation and testing;
- If there were identified problems what action did the examiner recommend/take (such as follow-up, administrative action) and did this appear reasonable;
- If there appeared to be problems in meeting milestone dates, why wasn't a waiver/extension action requested. Did this appear to be reasonable;
- If follow-up plans were identified, were the plans being followed; and
- Are current quarterly credit union Y2K reports accurate. How do quarterly reports compare to the examiner-prepared update information (e-form), FFIEC checklist and other information.

We performed the following procedures to meet our review objectives:

- Interviewed certain Central Office and regional office staff;
- Reviewed Central Office and regional guidance and procedures;
- Reviewed sample documentation for thirty-three FICUs (twenty-seven FCUs and six FISCUs) without waivers or extensions. Our review was limited to examination and contact documentation available in the regional offices. The documentation reviewed included the most recent documentation at the time of our review including:
 - Examination/contact Overview;
 - Examination/contact Confidential Section;
 - Examination/contact Supplementary Facts;
 - Document of Resolution;
 - Letter of Understanding and Agreement/Memorandum of Understanding;

Year 2000 Credit Union Progress In Meeting Renovation Milestone

- Regional Director Letter/State Supervisory Authority Letter;
- Most recent examiner E-form;
- Most recent credit union-prepared Y2K quarterly report to NCUA;
- Most recent FFIEC Y2K checklist;
- NCUA Y2K checklist (used prior to FFIEC checklist); and
- Other pertinent correspondence or documentation.

OBSERVATIONS

NCUA has reported that most federally insured credit union mission critical systems were renovated by the NCUA milestone of January 31, 1999. Our review found that many of those credit unions not fully renovated by the milestone date were not covered by waivers or administrative actions. NCUA has since made significant progress to address this situation.

We also found that there were some inaccuracies reported in the quarterly Y2K status reports prepared by credit unions and submitted to NCUA. The inaccuracies resulted in at least one region initially under reporting credit unions fully renovated for the period ended December 31, 1998. The agency has increased efforts to ensure the accuracy of the quarterly credit union status reports.

Credit Union Renovation Phase Status

NCUA reported that 95 percent of all natural person credit unions met the milestone of January 31, 1999, for completion of the renovation phase for mission critical systems. As of January 31, 1999, 515 of the 11,033 natural person and corporate credit unions had one or more mission critical systems in renovation - 162 federal credit unions and 353 federally insured state chartered credit unions. However, only 327 credit unions were covered by waivers or formal actions.

We reviewed documentation for 33 FICUs in two regions that were not fully renovated or with waivers for the milestone date. As of March 31, 1999, of the sample 33 FICUs, the agency reported 28 were fully renovated, 2 had applied for waivers, and the remaining 3 FICUs reports contained renovation reporting errors.

As of March 31, 1999, the number of credit unions not fully renovated had dropped to 287 or 2.7 percent. Of this group, 215 received waivers; 62 received formal actions such as Regional Director Letters or Letters of Understanding and Agreement; and the 10 remaining credit unions are no longer considered non-renovated due to quarterly reporting errors, reclassification of systems from critical to non-critical, and mergers.

Credit Union Quarterly Y2K Reports

FICUs without Y2K compliant information systems are required to prepare and submit quarterly status reports to NCUA. We reviewed the December 31, 1998 credit union prepared Y2K quarterly reports for the 33 sample FICUs. We found that there were errors in a significant number of the submitted reports.

Over 50 percent of the reports we reviewed contained inaccurate information. Eighteen of the 33 quarterly reports in our sample incorrectly reported the percentage of critical systems which were fully renovated. For example, some credit unions reported that they had no critical systems fully renovated while at the same time, they reported that all systems were in the testing or implementation phases. Inaccurate renovated system information resulted in one region initially reporting that only 36 percent of its FICUs were fully renovated as of December 31, 1998. When the data was subsequently reviewed by the regional office staff, it was determined that 70 percent of that region's FICUs were fully renovated.

Regional office staff in the second region of our review performed additional analysis on the quarterly reports to ensure that fully renovated FICUs were properly reported. Regional queries prepared on the December 31, 1998, Y2K quarterly reports to identify errors found critical system totals that did not reconcile; renovation 100% column out of balance; and testing 100% column out of balance.

Risk Ratings and Problem Identification

NCUA is a part of the Federal Financial Institution Examination Council (FFIEC). The FFIEC developed a work program for use by the regulators in evaluating the Y2K status of financial institutions. In addition to FFIEC guidance, the Central Office and regional offices provided instructions and clarifications regarding risk ratings². However, risk rating definitions are open to interpretation and examiner judgment in assigning the ratings to individual credit unions. Credit union examiners follow the FFIEC program including completion of a checklist and overall risk rating during the credit union examination or Y2K contact. Examiners were in the process of performing the examinations and Y2K contacts during the period of our review. It appeared that examiners were addressing Y2K problems in accordance with available guidance.

Examiners are also required to submit a Y2K update to NCUA for the credit union via an electronic update form (e-form) at the time of each examination or contact. A part of the e-form requires the examiner to risk rate the credit union high, medium, or low based on the examiner's judgment of the credit union's progress in becoming Y2K ready. The e-form update information;

² Examiners assign overall risk ratings of High, Medium, and Low to credit unions based on examiner judgment of the credit union's progress. "Use high, medium, or low risk categorization based on examiner judgment of the credit union's progress.... Credit unions rated as low risk are clearly demonstrating their progress towards compliance both in terms of systems remediation and interfaces with third parties. Those credit unions rated as high risk are not progressing towards compliance and in the examiner's judgment, management at these institutions does not have a sufficient understanding of the problem or its consequences. Credit unions rated as medium risk fall somewhere between the other two ratings, indicating a need for supervisory attention but not to a degree that necessitates intervention on NCUA's part." (*NCUA Bulletin No. 13610.02(REV)*, dated July 27, 1998)

examiner prepared FFIEC checklist information; and credit union prepared quarterly Y2K reports are used by the regional office and Central Office in determining overall Y2K readiness for credit unions. We found that the risk ratings were in agreement in most instances where examiner prepared FFIEC and e-form update documentation was available for comparable periods of time.

Our review of sample documentation indicated that, overall, examiners addressed problems noted and identified plans to resolve the problems. The dates of contact in some instances were early in the Y2K process when milestone dates had not expired and therefore the comments and plans to resolve the problems were brief and general in nature. We did note that Documents of Resolution were prepared when deemed necessary along with plans for future follow-up by the examiner. Our review focused on documentation available at the regional office and did not include follow-up with the examiner to determine if follow-up plans identified were actually carried out.

MATTERS FOR CONSIDERATION

The OIG is suggesting the following actions as matters for consideration by the NCUA Board and agency management:

- NCUA should continue to develop quality control procedures to review and upload correct information via the Y2K quarterly reports to ensure accuracy of reporting and to ensure that Y2K milestones are met in a timely manner.
- NCUA regional offices should review and compare FFIEC risk ratings with most recent examiner e-form updates to ensure the accuracy of risk ratings for reporting purposes and to ensure that higher risk rated credit unions receive adequate and timely follow-up

