

NATIONAL CREDIT UNION ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

**NCUA's Process for Reviewing
Federally Insured State Chartered
Credit Unions**

Report #OIG-05-06

June 8, 2005



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EXECUTIVE SUMMARY

The American credit union system is composed of state chartered and regulated credit unions and federally chartered and regulated credit unions. Prior to 1970 credit union member deposits (shares) were not protected by federal insurance common to bank and savings and loan association deposits. On October 19, 1970, Congress signed into law a program establishing federal share insurance for state chartered credit unions qualifying for the insurance, and for all federally chartered credit unions. To provide the insurance coverage for credit union shares, Congress established the National Credit Union Share Insurance Fund. Congress charged the National Credit Union Administration (NCUA) with oversight of the share insurance fund which basically insures member deposits up to \$100,000 per account, similar to the insurance provided by the Federal Deposit Insurance Corporation (FDIC) federal bank insurance fund.

To meet NCUA's mission of fostering the safety and soundness of federally insured credit unions, it is imperative that the agency manage the share insurance fund in an efficient and prudent manner. As of December 31, 2003, there were approximately 9,400 federally insured credit unions with insured deposits of \$477 billion. Of this total, 3,600 federally insured state chartered credit unions had insured deposits of \$215 billion, and 5,800 federal credit unions had insured deposits of \$262 billion.

Federally insured state chartered credit unions are regulated and monitored by the respective state supervisory authority (SSA) of the state where the credit union is chartered except for applicable federal laws and regulations which are regulated by NCUA. The SSA, in conjunction with NCUA, works with the credit unions to resolve problems that may affect the share insurance fund, with NCUA participating on joint examinations and supervision contacts.

Since federally insured state chartered credit unions represent 45 percent of deposits and 38 percent of credit unions insured by the share insurance fund, these deposits represent a significant potential risk to the fund. We performed our review to determine the adequacy of the NCUA process for determining and managing the risk that federally insured state chartered credit unions pose to the share insurance fund. Our three review objectives were to: (1) determine whether the NCUA process for determining and managing the risk that federally insured state chartered credit unions pose to the share insurance fund is adequate; (2) determine whether NCUA varies its approach depending on the inherent risk of each state supervisory authority program; and (3) determine whether NCUA performs formal reviews of all SSA examination reports and how the agency handles identified problems.

Our review work covered calendar years 2002 and 2003. Our procedures included a review of the applicable legal requirements, interviews, and a review of certain NCUA and SSA documentation. We did not verify the validity and reliability of information and data provided by the National Association of State Credit Union Supervisors (NASCUS), the various SSAs, or the historic share insurance fund loss figures reported by NCUA. (Please refer to the Appendix for more detail regarding our scope and methodology.)

Process for Managing Risk Appears Adequate

Overall, we found the NCUA process for managing risk to be adequate. NCUA's process for managing risk to the share insurance fund posed by federally insured state chartered credit unions is multi-faceted and includes operating agreements between NCUA and the various SSAs; state credit union examinations (both jointly with the SSA and independently through insurance reviews and contacts); and the review of state examination reports. We also analyzed losses to the share insurance fund for the past ten years for state and federally chartered credit unions. With the exception of 1994, losses reported have been relatively low for both state and federal charters compared to insured shares. Since 1998, losses reported have been under 5 cents per \$1,000 of insured shares for both state and federal charters. (See page 8.)

NCUA Approach Varies

The results of our review indicated that NCUA does vary its approach based on hours spent per \$100 million of insured shares. NCUA spent over one million hours examining and monitoring federally insured credit unions during the period 2002 through 2003 including 143,357 hours in federally insured state chartered credit unions. NCUA spent 54 percent of its state chartered credit union hours for the review period in credit unions rated CAMEL 1 and 2 representing 92 percent of insured shares. During the period 2002-2003, NCUA spent an average of 56 hours per \$100 million of insured shares in federally insured state chartered credit unions. NCUA spent from a high of 227 hours per \$100 million of insured shares in North Dakota's 39 state chartered credit unions, to a low of 10 hours per \$100 million of insured shares in Oregon's 23 state chartered credit unions.

We requested information from the National Association of State Credit Union Supervisors (NASCUS) regarding time spent by state supervisory authorities (SSA) in federally insured state chartered credit unions. NASCUS provided information from twenty-three SSA programs. We reviewed the information provided by NASCUS for the 23 SSA programs and compared it to information from NCUA regarding time spent in federally insured state chartered credit unions in the same 23 states. For the years 2002-2003, the 23 SSAs spent an average of 181 hours per \$100 million of insured shares. The NCUA spent an additional average of 33 hours per \$100 million of insured shares in state chartered credit unions for the insurance function in the same 23 states. The NCUA data for *federal credit unions* in the 23 states showed that NCUA spent an average of 159 hours per \$100 million of insured shares for these 23 states. Since the SSA is the regulator of state chartered credit unions, and NCUA is the insurer, it would appear reasonable that in most cases the regulator (SSA) would spend more time than the insurer in federally insured state chartered credit unions. (See page 17.)

NCUA Reviews of SSA Exam Reports

To ensure that NCUA is aware of activity in federally insured state chartered credit unions, from a federal insurance perspective, NCUA directly participates in examinations at the state chartered credit union and/or reviews SSA examination reports. We found that NCUA was adequately reviewing state examination reports and/or participating in examinations with the SSAs at state chartered credit unions. Our data review and analysis indicated that 99.7 percent of the state

chartered credit unions (3,597 out of 3,608 credit unions) had a formal NCUA exam review (Code 26 review) or joint examination (code 11) by NCUA between January 1, 2001 and December 31, 2003. Further, we found that NCUA and SSAs agreed on composite CAMEL ratings in 94 percent of joint examinations or Code 26 report reviews.

We found that in general there was no evidence in the reviewed documentation that the SSA was provided written feedback regarding the Code 26 reviews. However, there was evidence of appropriate other communications, such as documented discussions during examinations and contacts, between NCUA and the SSA addressing any differences, plans and suggestions.

We surveyed all 380 NCUA Principal Examiners to obtain input on any concerns or issues they may have had during a Code 26 review of a state chartered credit union examination report. We received 225 responses to our survey, a response rate of 59 percent. Of the responses, 84 percent identified no serious concerns. Sixteen percent (37) indicated concerns or issues. We reviewed each of the 37 responses and where a state chartered credit union was identified we reviewed additional examination or contact information. Based on the information provided by the examiner, and additional input provided by the appropriate NCUA regional offices, we determined that no additional follow-up was needed with the state chartered credit union or the SSA. (See page 22.)

Our report includes one matter for consideration by NCUA -- to more fully consider the NASCUS accreditation program to better leverage the resources it devotes to reviews of state chartered credit unions. In commenting on a draft of this report, NCUA took exception to our matter for consideration. NCUA told us that they support NASCUS' goal of improving the quality of state exam programs, however NCUA believes its process relies on the individual examiner's knowledge of their assigned credit unions and respective risks. For additional information, refer to our matter for consideration on page 25 as well as the section on NCUA and Stakeholder comments on page 26.

BACKGROUND

Congress has charged the NCUA with providing share insurance coverage to members of federally insured state chartered credit unions and federally chartered credit unions through the National Credit Union Share Insurance Fund (fund or NCUSIF). NCUA performs examinations in federally chartered credit unions and may accept the results of examinations at federally insured state chartered credit unions performed by the appropriate SSA on behalf of the NCUA Board. Insured shares in federally insured state chartered credit unions on December 31, 2003, represented forty five percent of total credit union insured shares.

NCUA Guidance

NCUA sets forth its guidance regarding the assessment of the financial and operational condition of FISCUs in Chapter 26 of the NCUA Examiner's Guide ("Guide"). Overall, Chapter 26 delineates insurance review objectives that focus on close cooperation between NCUA and state supervisory authorities to assess the condition of FISCUs and address material risk in the FISCUs that may negatively affect the NCUSIF. Currently, when state chartered credit unions apply for Federal share insurance, they sign an Agreement for Insurance of Accounts (Appendix 26A of the Guide) and agree to follow Part 741 of NCUA's Rules and Regulations.¹ The Guide also recognizes additional or alternative working agreements or informal arrangements between NCUA regional offices and SSAs to accommodate the unique circumstances of each state.

The Agreement (Appendix 26A) reflects the regulatory language in requiring the state chartered credit union applicant to agree "to permit and pay the cost of such examinations as the NCUA Board deems necessary for the protection of the interests of the NCUSIF." Further, item 2 of the Agreement provides that the state applicant will:

[p]ermit the Board to have access to all records and information concerning the affairs of the credit union, including any information or report related to an examination made by or for any other regulating authority, and to furnish such records, information, and reports upon request of the NCUA Board;

See sections 201(b)(1) and (2) and section 204, Title II, Federal Credit Union Act ("FCU Act"), 12 U.S.C. §§ 1781 et seq.

Chapter 26 of the Guide, read in conjunction with the terms of the Agreement (Appendix 26A), indicates that NCUA will accept and rely on reports of examination prepared by SSAs in all cases in which it is determined that the state examinations enable NCUA to assess adequately any risk to the insurance fund. The NCUA examiners, as part of their routine review of the State examination reports, assess the quality of the reports to determine whether they continue to enable NCUA to monitor the financial condition and the progress of the FISCU. The NCUA retains the option in cases in which a State examination report appears insufficient or the

¹ These rules and regulations are officially codified in Chapter VII, Title 12 of the Code of Federal Regulations, Parts 700-795. Part 741, in particular, codifies sections 201 and 204 of the Act (12 U.S.C. 1781 and 1784).

condition of an insured credit union, as indicated in the examination report or other sources, appears to be seriously deteriorating, to conduct an on-site review.

Legal Background

Applicable Law

Under Public Law 91-468, signed into law on October 19, 1970, a program of Federal share insurance for federally-regulated and state-chartered credit unions was established—the National Credit Union Share Insurance Fund (fund or NCUSIF). Section 201(b) of the FCU Act provides that credit unions seeking Federal insurance must agree:

- (1) to pay the reasonable cost of such examinations as the Board may deem necessary . . . and examinations conducted by State regulatory agencies shall be utilized by the [NCUA] Board . . . *to the maximum extent feasible*; [and]
- (2) to permit and pay the reasonable cost of such examinations as in the judgment of the Board may from time to time be necessary for the protection of the fund and of other insured credit unions.

(Emphasis added.) FCU Act § 201(b)(1) and (b)(2).

In addition, under section 204 of the Act, Congress empowered the NCUA Board

[t]o appoint examiners who shall have power, on its behalf, to examine any insured credit union, any credit union making application for insurance of its member accounts, or any closed insured credit union whenever in the judgment of the Board an examination is necessary to determine the condition of any such credit union for insurance purposes.

FCU Act § 204(a). Finally, the Act provides that the NCUA “may accept any report of examination made by or to any . . . authority having supervision of a State-chartered credit union” FCU Act § 204(d).

Legislative History

On August 19, 1970, the Senate Committee on Banking and Currency (“the Committee”) first reported S. 3822 (S. Rep. 91-1128), proposing the establishment of a Federal insurance system for member accounts in State and federally chartered credit unions. The Committee concurrently issued a Report (No. 91-1128), dated August 19, 1970, reflecting the issues that had been discussed at length during hearings held on the bill that took place on June 18 and 19, 1970. In that Report, the Committee adopted the “maximum extent feasible” language that appeared in the final law, stating that it had:

[a]mended [an earlier version of section 201(b)] to assure that examinations required by the [NCUA Board] and the resulting expense to credit unions be minimized. This was done by requiring the [NCUA Board] to so structure presently required examinations of Federal credit unions so that they could be used for insurance purposes. *The [NCUA Board] is also required to use State examinations to the maximum extent feasible.*

Report No. 91-1128 at 4 (emphasis added). The Committee Report also noted that those portions of the bill that addressed the costs associated with examinations of FISCUs would remain unchanged. Further the Report indicated that “[p]rovision is also made for acceptance of reports made by or to any State supervisory agency and for furnishing reports of examination by the [NCUA Board] to such authorities. *Id.* at 6.

The House, in its Report (91-1457) dated September 21, 1970, reiterated the Senate’s revisions to the bill, emphasizing in particular that NCUA is “required to use State examinations to the *maximum extent feasible.*” (Report No. 91-1457 at 4169 (emphasis added).) The House further emphasized that the final bill provided for acceptance of reports made by or to any State supervisory agency and for furnishing reports of examination by the [NCUA] to such authorities. *Id.* at 4171.

The bill was eventually voted on and passed by the Senate on September 2, 1970, and by the House on October 5, 1970. At the time of voting, there was little debate, on either side, on the bill’s provisions.

Conclusion

The current arrangement between the NCUA and the SSAs, as set forth in the Guide and Appendix 26A, is consistent with the rules and regulations governing the share insurance fund, as well as the legislative intent behind the statute. In particular, while the Guide as a preliminary matter *assumes* the use of examination reports prepared by SSAs, it likewise recognizes that the NCUA is not obliged to accept an SSA examination report in cases where an assessment of the state report indicates safety and soundness issues that could have a material effect on the FISCU’s operation.

Review Plan (Please refer to Appendix A for additional detail.)

Purpose and Objectives

The NCUA spends a significant part of its resources in ensuring that losses charged to the National Credit Union Share Insurance Fund (NCUSIF) from federally insured credit unions are minimized. Because 45 percent of NCUSIF-insured shares are deposited in state chartered and regulated credit unions, we decided to conduct a review of the NCUA FISCU program. Our three main objectives were to:

- Determine if the NCUA process for determining and managing the risk that FISCUs pose to the fund is adequate.
- Determine if NCUA varies its approach (level of effort) depending on the inherent risk of each SSA program.
- Determine if NCUA performs formal reviews of all FISCU examination reports (code 26); and how problems identified during NCUA report reviews are handled.

Scope and Methodology

Our review used information and data primarily for the year 2003. We also obtained and reviewed loss data for the years 1994 through 2002, and examination cycle information and hours spent in the federally insured state chartered credit union program by NCUA and the various SSAs, for the years 2002 and 2003.

We interviewed personnel from NCUA and NASCUS as well as the SSAs. In addition, to gain input from NCUA field examiners, we performed a limited survey of NCUA principal examiners. We further reviewed samples of NCUA and SSA operating agreements; SSA and NCUA examination information and documentation; and documents pertaining to NCUA's review of SSA examination reports. Finally, we obtained and analyzed data related to losses to the NCUSIF. We did not verify or test the loss data provided by NCUA.

Our review of the various agreements between NCUA and particular SSAs focused on the reasonableness of the terms of the agreements, as well as whether those agreements were consistent with the Document of Cooperation between NCUA and the NASCUS. In particular, we reviewed the agreements for consistency in addressing risks, communication, and monitoring by the SSA and NCUA. We then looked at a sample of federally insured state chartered credit union examination reports and NCUA report reviews for the following: (1) consistency with the SSA/NCUA agreement; (2) an adequate assessment of the risk factors; (3) evidence of appropriate NCUA staff interaction with the SSA; (4) timeliness of examinations; (5) adequacy of any follow-up plans by the SSA and NCUA; (6) CAMEL assignment differences between the SSAs and NCUA; and (7) the use of NCUA resources.

Our analysis of statistical data from NASCUS and NCUA provided information regarding hours spent in the federally insured state chartered credit union program, and losses per insured share dollar for state and federally chartered credit union.

Overall, we gained an understanding of the NCUA federally insured state chartered credit union program and its interaction with the state credit union programs. Our internal controls review was limited to staff interviews, and our review and analysis of federally insured state chartered credit union program processes identified in the operating agreements and examination and report review documentation. We did not note any irregularities in the documentation we reviewed.

Our review was conducted in accordance with Generally Accepted Government Auditing Standards, except for our limited review of internal controls and data discussed above.

REVIEW RESULTS

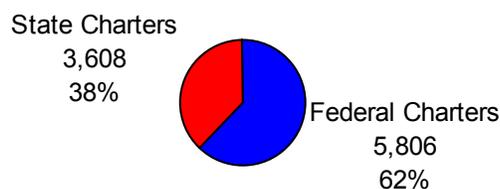
Section I

Process for Managing Risk to the Share Insurance Fund Appears Adequate

The NCUA and State regulatory agencies responsible for regulating state credit unions strive to engage in a cooperative and coordinated effort to fulfill the mutual goal of promoting a safe and sound credit union system. In addition to protecting the share insurance fund, this close cooperation between the Federal and State regulators promotes efficiency in the examination process, reduces the regulatory burden on state credit unions, and improves the supervisory process. Overall, we found that the NCUA process for managing risk to the insurance fund by federally insured state chartered credit unions is adequate. We found that NCUA's process is multi-faceted, and includes the development of operating agreements between NCUA and the various SSAs; state chartered credit union examinations (conducted jointly with the SSA as well as independently through insurance reviews and contacts); and NCUA's review of SSA examination reports. We also analyzed losses to the share insurance fund for the past ten year period for state and federally chartered credit unions. With the exception of 1994, losses reported have been relatively low for both state and federal charters compared to insured shares.

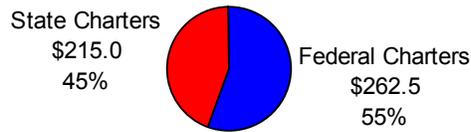
As of December 31, 2003, there were \$477.5 billion of insured shares in 9,414 federally insured natural person credit unions. This represented \$262.5 billion in insured shares in 5,806 federal credit unions, and \$215.0 billion in insured shares in 3,608 federally insured state chartered credit unions. (please refer to graphs below). For the calendar years 2002 and 2003, the NCUA recorded 1.04 million hours (this represents 530 thousand hours in 2002 and 514 thousand hours in 2003) spent in monitoring, supervising, and examining federally insured credit unions.

Number of Federally Insured Credit Unions 9,414



Source: NCUA 12-31-03, call report data as of January 5, 2004.

Federally Insured Credit Unions: Insured Shares
\$477.5
(in billions)



Source: NCUA 12-31-03, 5300 call report data as of March 22, 2004.

NCUA and SSA Agreements

Currently, a national NASCUS and NCUA agreement entitled “Document of Cooperation” is in effect. The Document of Cooperation was last revised and signed by the chairpersons of NASCUS and NCUA on December 17, 1998. The primary purpose of the Document is for ensuring the safety and soundness of all federally insured state chartered credit unions by joint efforts.

In most cases, SSAs enter into formal written or oral agreements with their local NCUA Regional Director to govern examination and contact operations at federally insured state chartered credit unions. The form of the agreement depends on the particular preferences of the SSA and/or the NCUA Regional Director. The agreements and credit union contact lists we reviewed appeared to incorporate the spirit of the Document of Cooperation.

Significantly, the agreements we reviewed appeared to adequately address risks and monitoring efforts. They also showed that there was adequate communication, including regular meetings, between SSAs and NCUA to address state chartered credit union issues.

In sum, our discussion with NCUA and three SSAs indicated the following key issues regarding the agreements:

- There may be no formalized agreement depending on the preference of the SSA or NCUA Regional Director.
- SSA information may influence the negotiation and final make up of the contact list. When differences of opinion arise it is not uncommon for NCUA to develop its own risk review schedule for federally insured state chartered credit unions.
- Exam cycle by state statute varies from 12 to 24 months or at discretion of the SSA.
- NCUA Regional Director normally meets twice a year with SSAs.
- NCUA supervisors and examiners make recommendations for joint exams.
- SSA field managers and NCUA supervisory examiners attend discussion meetings.
- Process works well to handle disagreements since there is interaction.

- One NCUA region told us they meet at least quarterly with those states having the largest potential risk.

The purpose of our agreement review was to determine and evaluate the consistency among federally insured state chartered credit unions of the agreement criteria; the consistency of CAMEL code assignment by the SSA and NCUA; and the adequacy of the agreements in addressing credit union risk, communication between the SSA and NCUA, and monitoring of the credit union by the SSA and NCUA. We identified the universe of agreements for NCUA Regions III, IV, and V and obtained copies of the 36 SSA agreements from the three regions for the year 2003. Of the 36 SSAs, ten written agreements or contact lists were not readily available because of the regional realignments effective in 2004. We selected a sample of five agreements from each of the three regions for review, for a total of fifteen agreements.

Our review of documentation for the sample of 15 agreements indicated that:

- 9 of 15 SSAs sampled had formal agreements with NCUA that covered the significant areas and spirit of 1998 NASCUS-NCUA Document of Cooperation. The remaining 6 SSAs had annual credit union contact lists with NCUA that substantially followed the spirit of the Document of Cooperation;
- One region preferred not to have formal agreements with the SSA; rather, it used contact lists with appropriate narrative;
- In the two regions with most of the agreements, the agreements were consistent with limited but appropriate adjustments;
- Credit union contact lists with SSAs were distinct by region and varied from much discussion to a basic listing of desired credit union contacts; and
- NCUA has no “preset” definition for large credit unions. Large is defined on a per-state basis by reviewing each credit union’s asset size. For example, in California large is defined as assets greater than \$1 billion; however, in Montana large is defined as assets greater than \$100 million.

Examinations and Contacts at Federally Insured State Chartered Credit Unions

All 15 sample credit unions contained key examination documentation (Overview, Document of Resolution, Examiner’s Findings, Confidential Section, and Supplementary Facts report sections) that addressed risk factors assessment, interaction with SSA as appropriate, timeliness of contact, and appropriate follow-up plans. Further, 12 of the 15 state chartered credit unions in the sample were identified in agreement/contact lists between NCUA and SSA. Agreements can be changed on short notice to address changing state credit union conditions. All 15 state chartered credit unions in the sample had an information form (form 110) prepared and uploaded to their computer systems, with 11 of the 15 identifying problems, supervision plans, and NCUA resources used.

Sample Review of NCUA Examinations of State Chartered Credit Unions

To determine and evaluate the adequacy and consistency of regional state chartered credit union programs we reviewed a sample of NCUA state chartered credit union examinations in California, Georgia, and Texas. We first identified the universe of state chartered credit union contacts and examinations performed by NCUA for 2003. There were 514 credit unions in this universe. From this universe, we then selected a sample of fifteen contacts and examinations for review (5 from each state). The sample of fifteen included 6 state chartered credit unions with insured shares under \$100 million; 7 state chartered credit unions with insured shares greater than \$100 million and less than \$1 billion; and 2 state chartered credit unions with insured shares greater than \$1 billion. The credit unions selected were usually the largest in their respective categories.

Our review included analyzing the following: credit union information contained in the SSA Agreement; the Form 110, which identifies problem information, financial information, and plans; Report Overview; Report Document of Resolution; Examiner's Findings; Confidential Section; and Supplementary Facts. We reviewed these documents to determine:

1. Consistency with the SSA agreement
2. Risk factors assessment
3. Interaction with the SSA
4. Timeliness of exam/contact
5. Follow-up plans
6. NCUA resources used

Our review of documentation for the sample of examinations found that:

- The Overview, Document of Resolution, Examiner's Findings, Confidential Section, and Supplementary Facts report sections were prepared as appropriate in all 15 sample state credit unions. They properly addressed risk factors assessment, interaction with SSA as appropriate, timeliness of contact, and appropriate follow-up plans;
- 12 of 15 state chartered credit unions in the sample were identified in agreement/contact lists between NCUA and SSA; and
- All 15 state chartered credit unions in the sample had a form 110 prepared and uploaded to their computer systems, with 11 identifying problems, supervision plans, and NCUA resources used.

Practices and Policies for Examinations of State Chartered Credit Unions

In our discussion with NCUA employees and the SSAs we learned the following regarding practices and policies for state credit union examinations, contacts and examination report reviews:

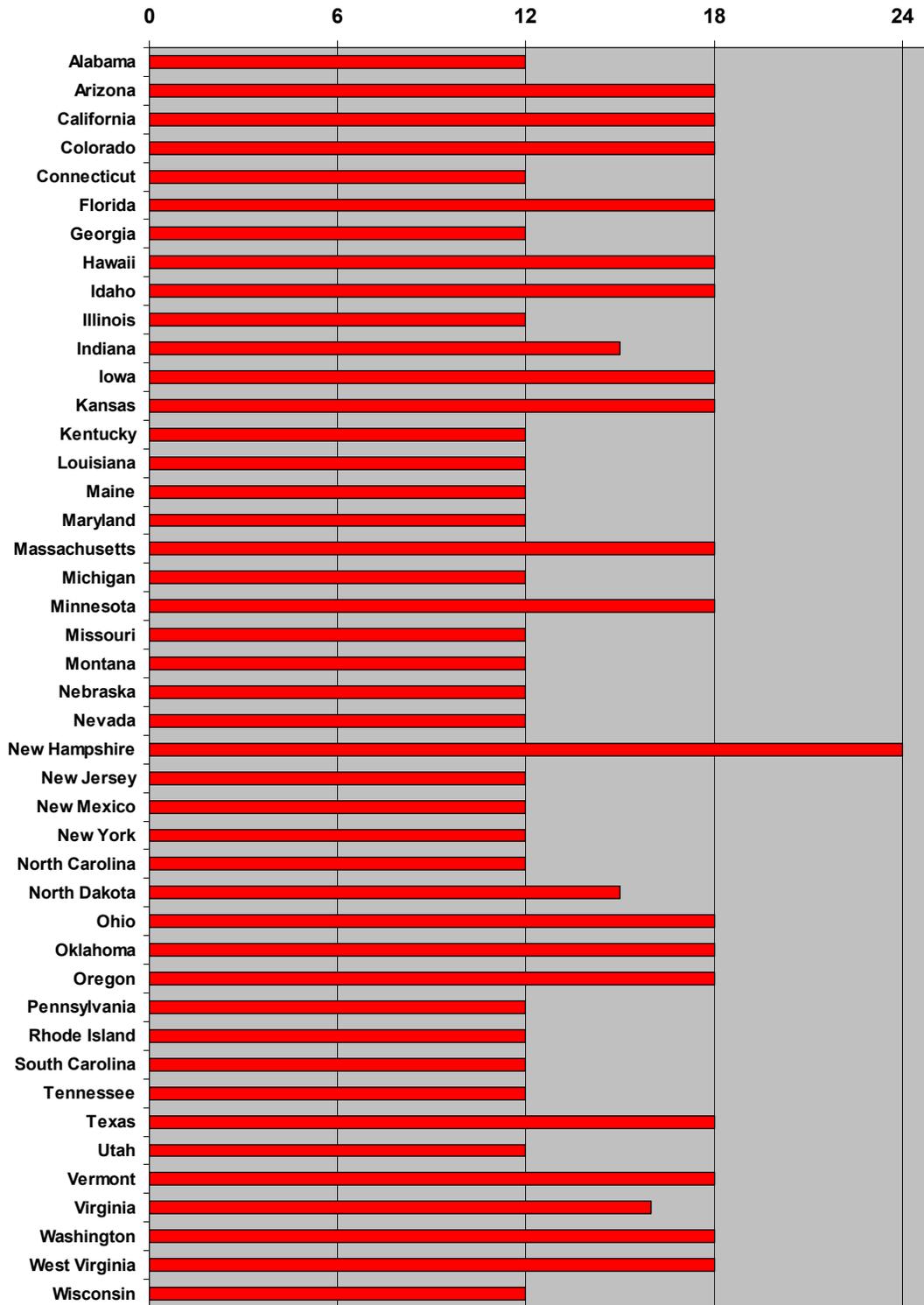
- NCUA historically spends 12-15 percent of its hours on the state program.
- Most SSAs use NCUA-supplied computers, and perform risk-based examinations.
- NCUA strives for shorter (currently about 2 days) contacts in state credit unions.
- Almost all NCUA insurance reviews of state chartered credit unions are joint reviews with the SSA.
- NCUA tools include: call reports, examination reports, risk analysis reports, and information as needed from the state credit unions.

- There is little or no difference between NCUA’s reviews of federally chartered or state chartered credit union examination reports.
- NCUA regions perform quality control reviews on a sample of reports.
- NCUA examiners review all state chartered credit union examination reports to determine if problems are identified and reasonable corrective action is indicated.
- If an NCUA examiner has questions about a report, he or she will follow-up with the SSA.
- NCUA examiners prepare a report of their formal reviews and forward it to their supervisory examiner and the regional office.
- While NCUA has not implemented a formal large credit union program, some regions now have pools of 4-6 experienced examiners to examine large credit unions.
- SSA statutory requirements and policies regarding examination scheduling indicated that the time frames for exams varied from no fixed period or as needed, to 3 years.
- SSAs indicated risk or CAMEL codes were used in examination scheduling annually, or on a 12-18 month basis.
- Most SSAs perform their own examinations. Only 11 of 44 accept CPA or NCUA exams in lieu of their own examinations.

State Supervisory Authority Examination Cycles

We requested information from NASCUS regarding member (SSA) examination cycles. NASCUS provided information from 44 of its members. The information indicated that 43 of 44 SSAs have an actual examination cycle of 12 to 18 months with half of the SSAs having a twelve month cycle. Refer to the chart on the following page for the specific cycles at each SSA.

State Supervisory Authority's Actual Exam Cycle Reported
months



Source: NASCUS 3-3-04

NCUA Reviews of State Examination Reports

NCUA reviews of SSA examination reports (code 26 reviews) were performed for all of the 15 state chartered credit unions in our sample. Our review of examination documentation and scope workbook information for code 26 work in our sample indicated that the NCUA information Form 110, Overview, Document of Resolution, Examiner's Findings, Supplementary Facts, and Attachment 22.1 information were adequately prepared and appropriately addressed pertinent issues. Where appropriate, NCUA identified reasonable follow-up and monitoring plans. We also found in our data review that NCUA is adequately reviewing all SSA examination reports and/or participating in examinations with the SSAs at state chartered credit unions.

To evaluate the adequacy and consistency of the regional monitoring program for SSA examinations of federally insured state chartered credit unions, we reviewed a sample of examination reports and NCUA reviews (Code 26 work) of those reports. We identified 366 credit unions in the review universe from California, Georgia, and Texas. From this universe, we selected a sample of 15 examinations for review, including 5 from each state. The sample of 15 included 6 state chartered credit unions with insured shares under \$100 million, 7 state chartered credit unions with insured shares greater than \$100 million and less than \$1 billion, and 2 state chartered credit unions with insured shares greater than \$1 billion. The credit unions selected were usually the largest state chartered credit union in each category.

Our review included analyzing the following information: NCUA Form 110, which identifies problem information; financial information and plans; Report Overview; Report Document of Resolution; Examiner's Findings; Confidential Section of the exam report; supplementary facts if available; and code 26 review reports. We reviewed these documents to determine:

1. Risk factors assessment
2. Interaction with the SSA
3. Timeliness of exam/contact
4. Follow-up plans
5. NCUA resources used
6. NCUA review comments and discussion

Our review of NCUA code 26 reviews of SSA state credit union examination reports found that:

- Code 26 reviews were performed by NCUA staff for the sample of 15 state chartered credit unions.
- Overall, the review of examination documentation and scope workbook information for code 26 work for the sample fifteen state credit unions indicated that, NCUA Form 110, Overview, Document of Resolution, Examiner's Findings, Supplementary Facts, and Attachment 22.1 information were adequately prepared and appropriate issues were addressed.
- Overall, appropriate and reasonable follow-up and monitoring plans were identified by NCUA.

Perspective of NCUA Staff and State Regulators on Guidance and Regulatory Approach

We found that the current arrangement between the NCUA and the SSAs regarding federally insured state chartered credit unions, as set forth in the NCUA Examiners Guide and its Appendix 26A, is consistent with the rules and regulations governing the share insurance fund. Overall, the SSAs and NCUA have a similar approach because both use similar computers, computerized examination techniques (AIRES), training, and off-site monitoring techniques. Moreover, NCUA and the SSAs work together as necessary during joint contacts at state chartered credit unions.

Our discussions with key NCUA staff and the state regulators for California, Texas, and Georgia revealed that, even from their different perspectives, they generally viewed the NCUA state chartered credit union program as very positive, with a good working relationship between NCUA and SSA staffs.

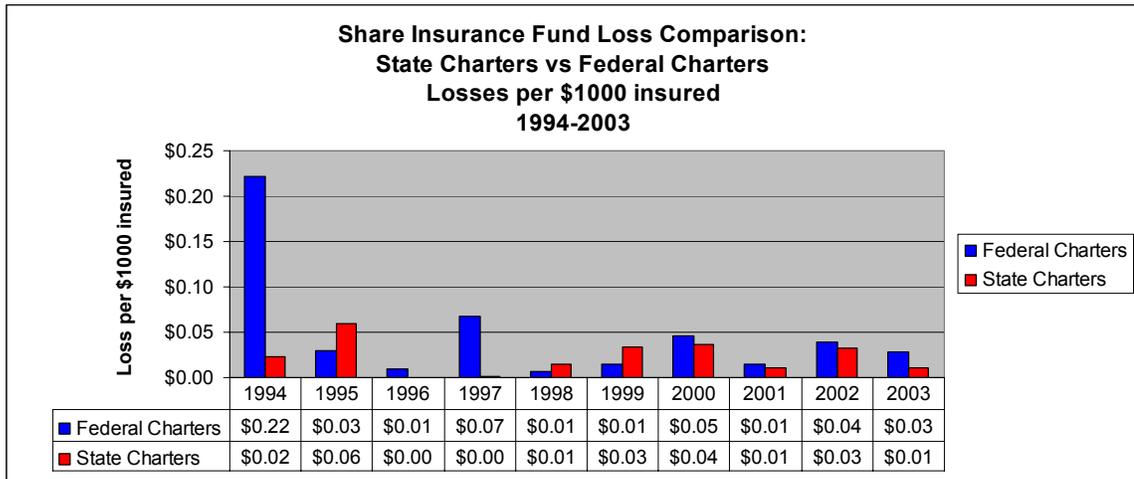
Many issues were brought to our attention by both NCUA and the SSAs. Some of the key issues mentioned during the discussions regarding regulatory approach included:

- NCUA and SSAs have a similar regulatory approach.
- There is a good working relationship between both groups of examiners.
- Both usually agree on the CAMEL rating for the credit union.
- NCUA and SSAs do not always work as a team. Consequently, both need to leverage resources more effectively.
- NASCUS has a training and certification program for state examiners and SSA. Currently, 28 of 48 NASCUS member SSAs have certified programs.
- There is a need for better communication and an NCUA definition of insurance risk.
- Concerns are handled at the lowest level possible (supervisor and/or examiner level). Usually there is little need for correspondence.
- SSAs indicated that NCUA should only go into those credit unions where there is an identified risk.
- NCUA indicated there is a need for hands-on knowledge of state chartered credit unions and therefore needs to go on site periodically.
- Often the SSA believes little is gained when working with NCUA.
- SSA views NCUA's feedback—in the form of correspondence--on state examination report reviews as too "picky" on some issues.
- SSA would like to see more Subject Matter Examiner training made available to state examiners.

Share Insurance Fund Losses

Reported losses to the National Credit Union Share Insurance Fund have been relatively low since 1995 for both state chartered credit unions as well as federally chartered credit unions. Since 1998, reported losses have been under 5 cents per \$1,000 of insured shares for both state and federal charters. More recently, federal charters experienced losses of 4 cents and 3 cents per \$1,000 of insured shares for the years 2002 and 2003 respectively. State charters had reported losses of 3 cents and 1 cent per \$1,000 of insured shares during this same period.

We must qualify these numbers because we were unable to completely verify the accuracy of the OCFO computer processed data from which the share insurance losses were obtained. Our preliminary assessment raised questions about the data's reliability and resource constraints limited us from performing additional testing of the data. We have scheduled a separate follow-up review to more fully test the accuracy of this data.



Source: NCUA OCFO Access database 2/12/04

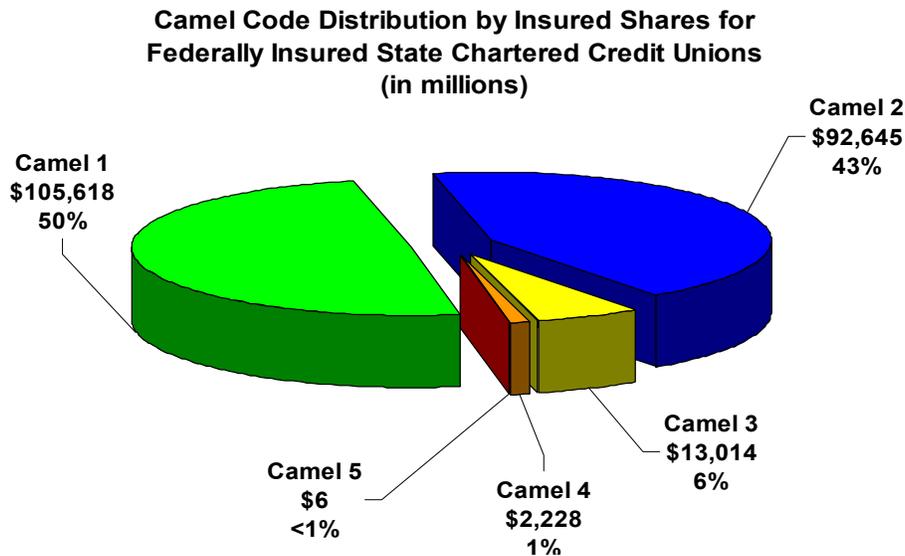
Note: Database maintained by OCFO that contains estimated losses from assisted mergers, liquidations, purchase and assumptions, and loan guarantee contracts. Insured shares from Insurance Fund Ten-Year Trends table included in the 2003 annual report.

Section II

NCUA Varies Level of Effort Based On Level of Risk

We set out to determine if NCUA varied its approach in federally insured state chartered credit unions, depending on the level of risk presented by the credit unions in the various SSA supervision programs.

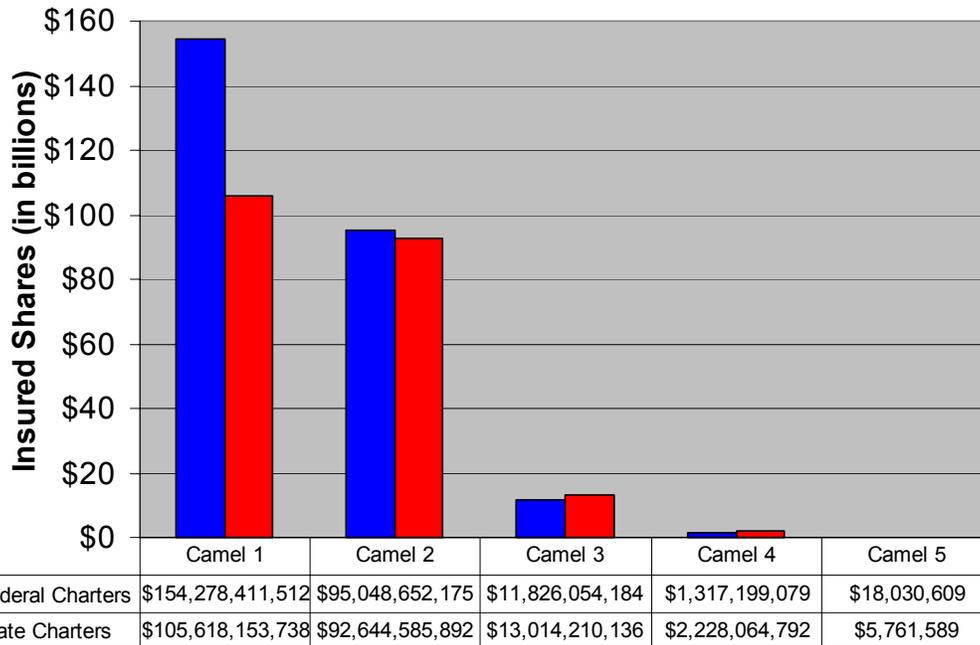
The results of our review indicated that NCUA varies its approach based on hours spent per \$100 million of insured shares. Proportionally, NCUA spends more of its state chartered credit union hours in credit unions assigned CAMEL code 1 and 2 (54 percent of hours on 92 percent of insured shares) compared to credit unions assigned CAMEL code 3, 4, and 5 (46 percent of hours on 8 percent of insured shares for CAMEL 3, 4, and 5). The following chart illustrates the proportion of insured shares by CAMEL code.



Source: December 31, 2003 call report downloaded on March 22, 2004. Camel ratings reflect last contact completed and uploaded prior to March 22, 2004.

The chart on the following page illustrates the CAMEL code distribution by federally insured shares for federal credit unions and state chartered credit unions. This bar chart shows that the overwhelming majority of the insured shares are in CAMEL code 1 and 2 credit unions.

Camel Code Comparison: Federal vs State Charters



Source: December 31, 2003 call report downloaded on March 22, 2004. Camel ratings reflect last contact completed and uploaded prior to March 22, 2004.

During the period 2002-2003, NCUA spent an average of 56 hours per \$100 million of insured shares in federally insured state chartered credit unions. NCUA spent from a high of 227 hours per \$100 million of insured shares in North Dakota's 39 state chartered credit unions, to a low of 10 hours per \$100 million of insured shares in Oregon's 23 state chartered credit unions. Of 46 states with state chartered credit unions, NCUA spent:

- Over 100 hours per \$100 million of insured shares in 7 states;
- Between 51-100 hours per \$100 million of insured shares in 11 states; and
- Between 10-50 hours per \$100 million of insured shares in 28 states.

This information presented in the following tables is not meant to indicate that NCUA plans its work based on the quality of the SSA program. In fact, the inherent nature of supervision results in NCUA spending more time relative to the size of the institution in smaller credit unions than large credit unions. The examiner's recommendations for expending resources are primarily based on their analysis of the institution and not the state regulator.

Comparison of NCUA hours spent on federally insured state chartered credit unions (FISCUs) by state

STATE	FISCUs #	NCUA HRS per \$100 million ins. sh.
ND	39	227
LA	56	155
MS	31	132
MT	14	129
NE	28	118
UT	73	111
NM	25	104
VT	31	98
KS	96	85
WV	8	84
ME	14	75
PA	79	70
HI	3	63
NJ	21	61
KY	36	56
MA	108	55
AK	2	54
AL	72	52
AZ	30	50
MN	105	49
NY	35	49
OH	153	49
IA	168	44
NH	23	42
SC	18	41
MO	159	37
FL	105	37
TN	128	37
IL	358	36
CT	47	36
NV	4	36
MI	271	33
RI	14	30
TX	242	27
GA	75	22
OK	28	22
ID	24	21
WI	298	20
CO	74	20
WA	89	19
VA	69	19
NC	97	18
CA	197	17
MD	7	17
IN	31	15
OR	23	10
TOTAL	3,608	33

STATE	FISCUs #	NCUA HRS per \$100 million ins. sh.
AK	2	54
AL	72	52
AZ	30	50
CA	197	17
CO	74	20
CT	47	36
FL	105	37
GA	75	22
HI	3	63
IA	168	44
ID	24	21
IL	358	36
IN	31	15
KS	96	85
KY	36	56
LA	56	155
MA	108	55
MD	7	17
ME	14	75
MI	271	33
MN	105	49
MO	159	37
MS	31	132
MT	14	129
NC	97	18
ND	39	227
NE	28	118
NH	23	42
NJ	21	61
NM	25	104
NV	4	36
NY	35	49
OH	153	49
OK	28	22
OR	23	10
PA	79	70
RI	14	30
SC	18	41
TN	128	37
TX	242	27
UT	73	111
VA	69	19
VT	31	98
WA	89	19
WI	298	20
WV	8	84
TOTAL	3,608	33

Source for table on previous page: NCUA hours reflect average annual hours for contacts completed during 2002 and 2003. Hours are limited to active, natural person, federally insured credit unions as of January 5, 2004. In addition, these hours reflect uploads of 2002 and 2003 contacts as of March 22, 2004. Note that some regions do not require uploads for contacts less than 3 hours.

NCUA spent over one million hours examining and monitoring federally insured credit unions during the period 2002 through 2003, including 143,357 hours in federally insured state chartered credit unions. NCUA spent 54 percent of its state chartered credit union hours for the review period in credit unions rated CAMEL 1 and 2, representing 92 percent of insured shares. NCUA spent the remaining hours in state chartered credit unions representing the remainder of insured shares as illustrated in the following table.

<i>CAMEL Code:</i>	<i>NCUA Hours (000)</i>	<i>Percent Total Hours</i>	<i>Insured Shares (billion)</i>	<i>Percent Insured Shares</i>
1	20.0	14%	\$105.6	49%
2	57.8	40%	92.6	43%
3	45.2	32%	13.0	6%
4	19.7	14%	2.2	1%
5	.6	0%	5 mil	0%
*	0	0%	1.5	1%
Totals:	143.3	100%	\$215.0	100%

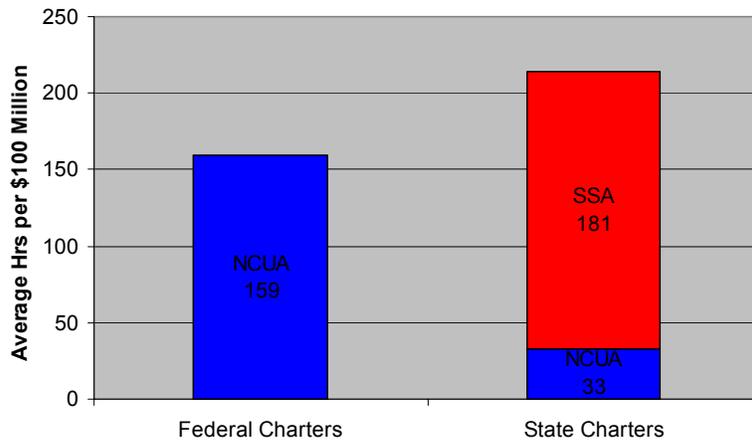
* FISCU in transition such as a merger or liquidation

Data we reviewed indicated that as of December 31, 2003, there were 3,608 federally insured state chartered credit unions, with insured shares of \$215 billion.

We requested information from NASCUS regarding time spent by SSAs in federally insured state chartered credit unions. NASCUS provided information from twenty-three SSA programs. We reviewed this information and compared it to information from NCUA regarding time spent in federally insured state chartered credit unions in the same 23 states.

For the years 2002-2003, the 23 SSAs spent an average of 181 hours per \$100 million of insured shares in state chartered credit unions. Additionally, NCUA examiners spent an average of 33 hours per \$100 million of insured shares in state chartered credit unions in these same 23 states for the insurance function. The NCUA data also showed that NCUA spent an average of 159 hours per \$100 million of insured shares in federal credit unions in the 23 states. Overall, it is reasonable that the SSA, as the regulator of state chartered credit unions, would spend more time than NCUA in state chartered credit unions. Please refer to the following chart.

**Comparison of average hours
spent on federally insured credit unions
in 23 states**



Source: NCUA and NASCUS for SSAs.

Note: SSA hours reported by NASCUS to OIG March 3, 2004 and represents 23 states (AK, AZ, CT, FL, GA, HI, IA, ID, IN, MA, MI, MO, NC, ND, NE, NY, OR, SC, TX, UT, WA, WI, WV). Insured shares from December 31, 2003, 5300 call report data downloaded on March 22, 2004. NCUA hours reflect average annual hours for contacts completed during 2002 and 2003. Hours are limited to active, natural person, federally insured credit unions as of 1/5/2004. In addition, these hours reflect uploads of 2002 and 2003 contacts as of 3/22/2004. Note that some regions do not require uploads for contacts less than 3 hours.

Section III

NCUA Reviews of Examination Reports Prepared by State Supervisory Authorities

Since 2001, NCUA has participated in 1,048 joint examinations, with an effective date since January 1, 2001, at federally insured state chartered credit unions. In those instances where NCUA did not participate in a state credit union examination, it relied on the examinations performed solely by the SSA. To ensure that NCUA is aware of activity in the state chartered credit union from a federal insurance perspective, NCUA reviews SSA examination reports and, as it considers it necessary or appropriate, participates directly in examinations at the state chartered credit union. For the period of our review, we found that NCUA was adequately and appropriately reviewing SSA examination reports and/or participating in examinations with the SSAs at state chartered credit unions. Further, we found that NCUA and SSAs agreed on composite CAMEL ratings in 94 percent of 3,556 joint examinations or Code 26 report reviews with an effective date since January 1, 2002.

Using the data recorded by NCUA in its database, we prepared data runs for the years 2002 and 2003, to determine if NCUA participated in a joint examination with the SSA or was reviewing all SSA-prepared examinations performed at state credit unions. Our review work primarily involved data retrieval and analysis regarding:

- identifying the universe of all state chartered credit union exams performed for the review period;
- searching the database to identify the universe of Code 26 reviews NCUA performed on SSA examination reports (Code 26 reviews);
- identifying and matching examinations with Code 26 reviews to identify those state chartered credit unions without a Code 26 review; and
- analyzing a random sample of SSA exams without a Code 26 review to determine:
 1. Why a review was not performed
 2. Monitoring plans and actual efforts

Our data review and analysis indicated that 99.7 percent of the state chartered credit unions (3,597 out of 3,608 credit unions) had a formal Code 26 review or Code 11 examination by NCUA between January 1, 2001 and December 31, 2003. Of the remaining eleven credit unions, we were able to account for all eleven as having either a review prior to 2001, were liquidating, merging, had an issue date in 2003, or had a Code 10 examination code.

NCUA Communication with State Supervisory Authorities

One purpose of our review was to determine the adequacy of NCUA's handling of differences between NCUA and SSA for Capital, Assets, Management, Earnings, and Liquidity (CAMEL) ratings, and the composite CAMEL ratings assigned to state chartered credit unions for contacts for the years 2002 and 2003.

Our review included:

- Searching and reviewing the NCUA database to identify the universe of all state chartered credit union Code 26 examination reviews with differences between SSA and NCUA in CAMEL composite codes for the year ending December 31, 2003.
- Selecting a random sample of 21 reported differences in composite CAMEL codes between NCUA and the SSA, from a universe of 83 for follow-up review to determine if:
 1. differences identified in the sample were addressed;
 2. there was communication between the region and SSA; and
 3. communication was timely, appropriate, and resolved noted problems.
- Sending a survey to 380 NCUA Principal Examiners to obtain input regarding Code 26 reviews they performed.

We identified 3,556 state chartered credit unions that had undergone either a joint examination or Code 26 review with an effective date after January 2, 2002. In those credit unions, NCUA and the SSAs agreed on the composite CAMEL rating in 94 percent of the instances. In 220 instances (6 percent) where there was a difference in the CAMEL, there were 83 credit unions in which NCUA's composite CAMEL code was 3 or greater, and where NCUA's composite rating was more conservative than the SSA CAMEL composite. From this universe of 83, we selected a random sample of 21 contacts. Our review was intended to determine if differences were addressed and handled in a timely manner. Also, we wanted to determine if there was documentation sent by NCUA to the SSA discussing the CAMEL differences.

We found no written evidence in the reviewed documentation to show that NCUA contacted the SSA and provided feedback regarding the Code 26 reviews. However, there was evidence of other communications between NCUA and the SSA regarding plans and suggestions. We determined that additional follow-up was not warranted during our review.

Survey of NCUA Examiners

We surveyed all 380 NCUA Principal Examiners to obtain input on any serious concerns or issues they may have had during a Code 26 review of a state chartered credit union examination report. We received 225 responses to our survey, a response rate of 59 percent.

Of the responses, 84 percent identified no serious concerns. Sixteen percent (37) indicated concerns or issues. For each of these 37 responses, we reviewed additional examination or contact information. Based on the information provided by the examiner, and additional input provided by the appropriate NCUA regional offices, we determined that no additional follow-up was needed with the state chartered credit union or the state supervisory authority.

The following table is a summary of our examiner survey.

Description	Final	Response Rate
Total Surveys Sent	380	
Total Responses	225	59%
Negative Responses (1)	188	84%
Positive Responses (2)	37	16%
	225	100%

(1) Negative Responses represent no serious concerns or issues expressed.

(2) Positive Responses represent examiner expressed concerns. The comments were reviewed during the audit and in some instances were given additional audit follow-up.

MATTER FOR CONSIDERATION

The National Association of State Credit Union Supervisors (NASCUS) has an accreditation program for its member state supervisory authorities (SSAs). The intent of this accreditation program is to improve and enhance SSA efforts in the examination and supervision of state chartered credit unions. Currently, 28 of 48 members have received accreditation and are responsible for over 80 percent of the total assets in state chartered credit unions.

We believe that NCUA should use all of the tools available in its decision making process. In this regard, we believe NCUA should consider the NASCUS accreditation program to better leverage the resources it devotes to the state chartered credit union program. The risk presented by any particular credit union should be the over-riding factor in NCUA's decision to expend resources but accreditation can serve as one more tool that NCUA could use in this process.

NCUA Comments

In a June 3, 2005, memo, NCUA's Executive Director provided comments to our draft report. In the Executive Director's comment letter, he stated, "I believe your recommendation for the NCUA to consider the NASCUS accreditation program as a tool in its decision making process should be removed from the report. As you are aware, the NASCUS is a trade organization for both SSAs and over 600 federally-insured state chartered credit unions. I understand NASCUS markets this program to the SSAs and your comments might be construed as an endorsement of this program."

OIG Response to NCUA Comments

The OIG did not make a firm recommendation or endorse this program because we did not independently evaluate or assess the program. However, we stand by our matter for consideration in that we believe the NASCUS accreditation program is a tool that NCUA should consider as part of its deliberative decision making process in allocating NCUA resources.

NCUA AND STAKEHOLDER COMMENTS

We provided our draft report and solicited comments from NCUA's Office of Examination and Insurance, and NCUA Regions III, IV, and V. We also provided a copy of our draft report for comments to the National Association of State Credit Union Supervisors (NASCUS).

We received comments from each NCUA office that was provided a draft of this report and their technical comments have been incorporated in the applicable sections of the body of this report. We also received a comment letter from the Office of the Executive Director (OED) primarily expressing OED's concern with our matter for consideration. The Executive Director's comments and our response to those comments appear in the body of the report immediately after the matter for consideration.

The President and Chief Executive Officer of NASCUS provided a written response to our draft report and supported our matter for consideration. NASCUS replied, "As your draft report points out, NCUA relies primarily on state regulatory agency examinations of state-chartered federally insured credit unions for assessing risks to the Fund in the state system. Given NCUA's reliance on state agencies, it is appropriate that further reliance be given to those states that have met the high standards of NASCUS Accreditation." NASCUS also commented that our report presented a comprehensive view of the NCUA/state regulator partnership.

Review Scope and Methodology

We interviewed and held discussions with NCUA staff in the Office of Examination and Insurance; staff in NCUA Regions III (Atlanta, GA) and V (Tempe, AZ); National Association of State Credit Union Supervisors (NASCUS) staff; and the state supervisors for credit unions in California, Texas, and Georgia. In addition, we reviewed a sample of 15 operational agreements between state supervisory authorities (SSA) and NCUA; a sample of NCUA and SSA state credit union examination and supervision documentation; a sample of NCUA review documentation of SSA examination reports; and conducted a survey of all 380 NCUA Principal Examiners. Our review also considered NCUA data from the central database for all five regions (Albany, NY, Alexandria, VA, Atlanta, GA, Austin, TX, and Tempe, AZ). We also received and reviewed data from the 48 SSAs, and specifically the examination and supervision hours spent by 23 SSAs. We did not verify the validity and reliability of data or information provided by the NCUA, or information provided by NASCUS and the various SSAs. Our review of internal controls was limited to information we received during our interviews with staff and documentation available during our review.

Survey Objective

Our objective during the survey phase of the review was to determine the adequacy of NCUA's process for determining and managing the risk federally insured state chartered credit unions posed to the Share Insurance Fund. We performed our work in accordance with government auditing standards with the exception of determining the validity and reliability of information provided by both the NCUA and the members of NASCUS.

Survey Scope

Our survey scope included:

- Reviewing the legal requirements for NCUA monitoring of state chartered credit unions
- Obtaining staff input from SSAs, NCUA, NASCUS, and the FDIC
- Reviewing a sample of SSA and NCUA agreements
- Reviewing a sample of SSA and state chartered credit union examinations

The period of our data review was for the calendar year ending December 31, 2003.

Survey Procedures and Methodology

Our survey work included the following procedures and methodology:

Reviewed Legal Requirements

- Obtained and reviewed relevant laws and regulations to determine legal requirements for the NCUA state credit union program
- Compared requirements with program to determine compliance and consistency

APPENDIX

Obtained staff input from SSA, NCUA, NASCUS and FDIC

- Contacted and held discussions with the state supervisory authorities for California, Texas, and Georgia
- Contacted and held discussions with NCUA regional staff in Region III (Atlanta, GA), and Region V (Tempe, AZ)
- Contacted and held discussions with NCUA Office of Examination and Insurance (E&I) staff
- Contacted and held discussions with National Association of State Credit Union Supervisors (NASCUS)
- Held discussion with staff of the Federal Deposit Insurance Corporation (FDIC)

Reviewed a Sample of SSA and NCUA Agreements

- Identified universe of agreements for three selected NCUA regions
- Selected survey sample of five agreements from Regions III, IV, and V
- Reviewed selected sample for:
 1. Consistency with agreement criteria
 2. Consistency of SSA/NCUA CAMEL codes
 3. Adequacy of addressing risks
 4. Adequacy of communication SSA/NCUA
 5. Adequacy of monitoring by SSA/NCUA

Reviewed a sample of NCUA state chartered credit union contacts and examinations

- Identified universe of 2003 NCUA state chartered credit union exams/contacts
- Selected a survey sample of examinations/contacts
- Reviewed selected sample for:
 1. Consistency with SSA agreement
 2. Risk factors assessment
 3. Interaction with SSA
 4. Timeliness of exam/contact
 5. Follow-up plans
 6. NCUA resources used

Reviewed a sample of SSA state chartered credit union examinations that were reviewed by NCUA

- Identified universe of 2003 NCUA FISCU exams/contacts
- Selected a survey sample of reviewed examinations/contacts
- Reviewed selected sample for:
 1. Consistency with SSA agreement
 2. Risk factors assessment
 3. Interaction with SSA
 4. Timeliness of exam/contact
 5. Follow-up plans
 6. NCUA resources used

APPENDIX

Review Objectives

At the conclusion of our survey, we extended this review and added the following objectives:

- Determine if NCUA varies its approach depending on the inherent risk of each SSA program; and
- Determine if NCUA performs formal reviews of all SSA examination reports and how the agency handles identified problems.

Review Procedures and Methodology

Our review work included the following procedures and methodology to determine if NCUA has a varying examination approach depending on the SSA program and included primarily data retrieval and analysis regarding:

- identifying NCUA hours used in FISCU work codes for the review period;
- identifying NASCUS-provided hours by SSA for state chartered credit union exams and supervision;
- calculating overall average NCUA hour(s) per insured share dollar;
- calculating overall average SSA hour(s) per insured share dollar;
- calculating average NCUA hour(s) per insured share dollar by state program; and
- calculating average NASCUS hour(s) per insured share dollar by state program.

Review Procedures and Methodology

Our review work also included the following procedures and methodology to determine if NCUA performs formal reviews of all FISCU examination reports and how NCUA handles identified problems where the NCUA composite CAMEL code differs from the SSA composite CAMEL code. Our work involved primarily data retrieval and analysis for the review period regarding:

- identifying universe of all FISCU exams performed for review period;
- searching database to identify universe of Code 26 reviews performed;
- identifying and match examination search with Code 26 search to identify those FISCUs without a Code 26 contact;
- analysis of random sample from non-Code 26 exams for follow-up review to determine:
 1. Reason for no review
 2. Monitoring plans and actual efforts
- searching database to identify universe of all FISCU Code 26 exam reviews with identified problems (differences between SSA and NCUA in CAMEL composite codes); and
- selecting random sample from identified universe for analysis to determine:
 1. Were differences identified in sample addressed;
 2. Was there communication between the region and SSA; and
 3. Was the communication timely, appropriate, and did it resolve any problems noted.

