



NCUA
National Credit Union Administration

**OFFICE OF INSPECTOR
GENERAL**

**AUDIT OF
THE NCUA'S JOINT EXAMINATION PROCESS
WITH STATE SUPERVISORY AUTHORITIES**

**Report #OIG-19-11
December 18, 2019**





Office of Inspector General

SENT BY EMAIL

TO: Distribution List

FROM: Inspector General James W. Hage

A handwritten signature in black ink, appearing to read "James W. Hage", is positioned to the right of the "FROM:" field.

SUBJ: Audit of the NCUA's Joint Examination Process with
State Supervisory Authorities

DATE: December 18, 2019

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) conducted this self-initiated audit to assess the NCUA's joint examination process with state supervisory authorities. The objectives of our audit were to determine: 1) whether the NCUA provided shared oversight of federally insured state-chartered credit unions (FISCUs) to assess their condition and address material risks that could negatively affect the Share Insurance Fund; and 2) whether the NCUA effectively monitored FISCUs using off-site monitoring tools and joint oversight processes with state supervisory authorities (SSAs).

Results of our audit determined the NCUA provides shared oversight of FISCUs and that the NCUA effectively monitors FISCUs using off-site monitoring tools. Although we determined the NCUA met the objectives of our audit, we also determined there are aspects of the joint examination process with the SSAs that are in need of improvement. We are making one recommendation in our report and note that NCUA management has already taken, or plans to take, corrective action to address the issues we identified.

We appreciate the cooperation and courtesies NCUA management and staff provided to us during the audit. If you have any questions on the report and its recommendation, please contact me at 703-518-6350.

Distribution List:

Chairman Rodney E. Hood
Board Member J. Mark McWatters
Board Member Todd M. Harper
Executive Director Mark Treichel
Acting General Counsel Frank Kressman
Deputy Executive Director John Kutchey
Special Asst. to the ED Joy Lee
Deputy Chief of Staff Gisele Roget
OEAC Deputy Director Michael Sinacore
E&I Director Larry Fazio
E&I Deputy Director Timothy Segerson

Attachment

TABLE OF CONTENTS

<u>Section</u>	<u>Page</u>
EXECUTIVE SUMMARY	1
BACKGROUND	2
RESULTS IN DETAIL.....	9
Optional SSA Operating Agreements Need Updating.....	9
Revisions to Guidance Needed for WCC 26 Reviews.....	11
Consistent Documentation of Decisions on Follow-up Actions Needed.....	14
APPENDICES:	
A. Objective, Scope, and Methodology	16
B. NCUA Management Response	18
C. Acronyms and Abbreviations.....	19



EXECUTIVE SUMMARY

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) conducted this self-initiated audit to assess the NCUA's joint examination process with state supervisory authorities. The objectives of our audit were to determine: 1) whether the NCUA provided shared oversight of federally insured state-chartered credit unions (FISCUs) to assess their condition and address material risks that could negatively affect the Share Insurance Fund; and 2) whether the NCUA effectively monitored FISCUs using off-site monitoring tools and joint oversight processes with state supervisory authorities (SSAs). The scope of our audit covered the period of January 2013 through December 2018.

Our audit determined the NCUA provides shared oversight of FISCUs and that the NCUA effectively monitors FISCUs using off-site monitoring tools. Although we determined the NCUA met the objectives of our audit, we also determined there are aspects of the joint examination process with the SSAs that are in need of improvement. Specifically, we found that NCUA's regional offices did not have updated optional operating agreements with each individual SSA that defined roles and responsibilities at a high level for joint on-site examinations of FISCUs. In addition, we determined that NCUA management needed to enhance its guidance to clarify work classification code (WCC) 26 reviews of FISCUs when NCUA examiners participate in joint examinations. Finally, although not a requirement, we determined that as a best practice, supervisory examiners (SE) did not consistently document their decisions on follow-up actions recommended by examiners after completing WCC 26 reviews. We are making one recommendation in our report and note that NCUA management has already taken, or plans to take, corrective action to address the issues we identified.

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



BACKGROUND

The NCUA is an independent federal agency created by the U.S. Congress to regulate, charter, and supervise federally insured credit unions. The NCUA's organizational structure consists of a Central Office (CO), Asset Management and Assistance Center (AMAC), and three regional offices.¹

Within the CO, the Office of National Examinations and Supervision (ONES) is responsible for overseeing corporate credit unions and consumer credit unions with \$10 billion or more in assets. ONES ensures the safety and soundness of all corporates and consumer credit unions with assets of \$10 billion or more. The Office of Examination and Insurance (E&I) is responsible for the agency's supervision programs by providing leadership and collaborating with other agency offices and regions on the establishment of sound policy, direction, and quality control over the examination, surveillance, and problem resolution programs for federally insured credit unions.

As of December 31, 2018, over 116 million members had \$1.1 trillion in insured deposits at approximately 5,400 federally insured credit unions (FICUs), which includes approximately 2,000 FISCUs. The NCUA's three regional offices and ONES are responsible for the day-to-day examination and supervision of FICUs to ensure their safety and soundness. The NCUA and SSAs partner and coordinate to examine and supervise FISCUs. This close cooperation improves the supervisory process, promotes efficiency, and reduces regulatory burden on FISCUs.

The National Credit Union Share Insurance Fund (SIF) provides the same account coverage for FISCUs as it does other FICUs, although the NCUA uses a different supervision process to monitor the insurance risk of FISCUs.

The NCUA Examination Process

The examination and supervision program is the most important component of managing risks to the SIF and protecting members. Pre-planning and planning are vital for examinations. According to the NSPM:

Advance pre-planning is critical for effective examinations. Poor planning before going onsite often leads to unnecessary burden on credit unions and miscommunication between the NCUA and credit union staff... When planning for a FISCU exam, examiners will ensure coordination with the SSA and compliance with the NSPM. This includes coordinating with the SSA on the planned scope and coordination between specialists scheduled for the exam (for example, create one Items Needed list), to the maximum extent possible. Examiners should also inquire and discuss any changes since the last exam with the SSA.

¹ The three regional offices are Eastern, Southern, and Western.



The NCUA's examination process includes evaluating CAMEL² components, risk ratings, and reviewing qualitative and quantitative measures. The NCUA uses the CAMEL Rating System for evaluating the soundness of credit unions on a uniform basis, identifying degree of risk to the SIF, and identifying credit unions requiring special supervisory attention. The CAMEL rating includes consideration of key ratios, supporting ratios, and trends. At the conclusion of an examination, examiners assign CAMEL and risk ratings.

For FISCUs, the NCUA focuses its risk concerns to insurance risk, which include whether:

- Examiners adequately addressed material risks within the FISCU,
- FISCUs understand the seriousness of any identified risks, and
- An agreement or plan exists for resolving unacceptable risks in a timely manner.

Examination Programs

Instruction 5000.20, *Examination Scope* states that to effectively supervise and examine FISCUs, the NCUA employs two main types of examination programs based on the type, size, and complexity of a credit union and the risks present: the risk-focused examination (RFE) program and the small credit union examination program (SCUEP).

Focused Examination (RFE) Program

The RFE program gives field staff the authority to opt out of certain review areas when, in their professional judgment, a credit union's operations and level of risk warrant doing so. Field staff evaluate the degree to which credit unions identify, measure, monitor, and control existing and potential risks in their operations. RFE procedures often include using off-site monitoring tools, including completing risk evaluation reports for credit unions in seven categories of risk: Credit, Interest Rate, Liquidity, Transaction, Compliance, Strategic, and Reputation. Most joint FISCU examinations are conducted under the RFE program.

SCUEP Program

Although not required or commonly used in FISCUs, in 2012, the NCUA adopted the SCUEP program for supervision of small credit unions and in 2015, implemented a new SCUEP defined-scope examination that included pre-determined review procedures that focused on internal controls, recordkeeping, and lending, which the NCUA considered to be the areas of greatest risk in small credit unions, including the risk that small credit unions may be more susceptible to insider fraud due to having limited staff.

² The acronym CAMEL derives its name from the following components: Capital Adequacy, Asset Quality, Management, Earnings, and Liquidity/Asset-Liability Management.



Examination Tools

The National Supervision Policy Manual (NSPM) establishes policies, procedures, and guidelines for district management (defined to be “[m]anaging and maintaining continuous and detailed knowledge of an assigned district of credit unions”), supervision of credit unions, and quality assurance. The NSPM provides that examiners will use all tools available to identify current and emerging risks in credit unions, including using the Examiner’s Guide. The Examiner’s Guide states examiners should monitor FISCUs by reviewing examination reports completed by the SSA (WCC 26 reviews),³ 5300 Call Reports,⁴ the scope workbook,⁵ and Financial Performance Reports.⁶ Additional tools may include reviewing credit union financial statements, media reports about the credit union, risk management reports using call report data, and having discussions with credit union officials, trade organizations, or the SSA. All of these tools may alert the SSA, regional office, and examination staff to adverse conditions affecting credit unions and may trigger NCUA regional communication with the SSA for more information, revision of the scope workbook, and possible inclusion of the credit union in future NCUA onsite contacts. If the tools do not indicate severe risks, the NCUA usually does not require or take further action.

Work Classification Codes

The NCUA categorizes examination activities through WCCs, which examiners use on weekly time reports to capture the number of hours spent performing work related to a specific code. The use of WCCs allows the NCUA to monitor programs identified in the NCUA annual budget. NCUA Instruction No. 5300.13 provides the policy for using WCCs in AIRES.⁷ The Instruction provides that examiners use WCC 10 for regular examinations of FCUs and, as shown in Table 1 (below), the following WCCs for examination activities related to FISCUs:

³ Each state that has FISCUs has its own State Supervisory Authority, which is responsible for completing examinations of FISCUs. Five states and the District of Columbia, Guam, Puerto Rico, and the Virgin Islands do not have FISCUs.

⁴ The 5300 Call Report is a report of credit union financial information that includes assets, liabilities, capital, income, and expenses.

⁵ The scope workbook allows the examiner, who is onsite and best able to assess the risks in the credit union, to determine the scope appropriate for the areas of risk. The decision to opt out of a review area must be documented and well supported.

⁶ The Financial Performance Report (FPR) presents quarterly Call Report data submitted by credit unions in the form of ratios, percentages, dollar amounts, and graphs.

⁷ Automated, Integrated, Regulatory Examination System (AIRES) is the primary credit union examination tool that incorporates databases, Excel workbooks, Word documents, and other interfaces for documenting examinations or contacts. The NCUA plans to replace AIRES with the Modern Examination and Risk Identification Tool (MERIT) in mid-to-late 2020. MERIT is being piloted as of the date of this report.



Table 1

Work Classification Codes for Examination Activity Related to FISCUs		
Classification	WCC	Definition
Examination FISCU - Regular	11	Regular examination/insurance review of any federally insured, state-chartered credit union
Supervision On-Site – FISCU	23	On-site supervision and follow-up exam of a FISCU
Review of State Examinations	26	Evaluation of examination reports completed by a state supervisory authority ⁸
Supervision Off-Site – FISCU	28	Off-site supervision of a state-chartered credit union
Pre-Exam Planning – FISCU	95	Planning prior to a FISCU joint examination or insurance review

WCC 11

NCUA examiners use WCC 11 when they conduct an examination of a FISCU. In the majority of FISCU examinations, the NCUA will conduct a joint examination with the SSA. During a joint examination, the NCUA examiners divide examination scope steps with the SSAs, with each agreeing on which areas of the examination they will accomplish. SSA examiners take the lead on joint examinations unless they otherwise agree not to, in which case NCUA examiners will take the lead. At the end of most joint examinations, SSA and NCUA examiners collaborate to issue a final examination report. However, in rare instances when the NCUA and the SSA do not agree on a particular issue, the NCUA will issue its own report to credit union management independent of the SSA's report.

In 2018, the NCUA was organized under its prior structure of five regional offices and ONES. At that time, the five regional offices and ONES conducted a total of 3,316 examinations, 712 (21 percent) of which were in FISCUs. Table 2 (below) provides details of the number of FISCUs, the number of FISCU examinations (the majority (657 of the 712) are joint examinations), and the number of FISCU reviews conducted by NCUA in 2018:

⁸ NCUA examiners conduct WCC 26 reviews for all state examination reports whether the NCUA participated jointly on the examination or not.

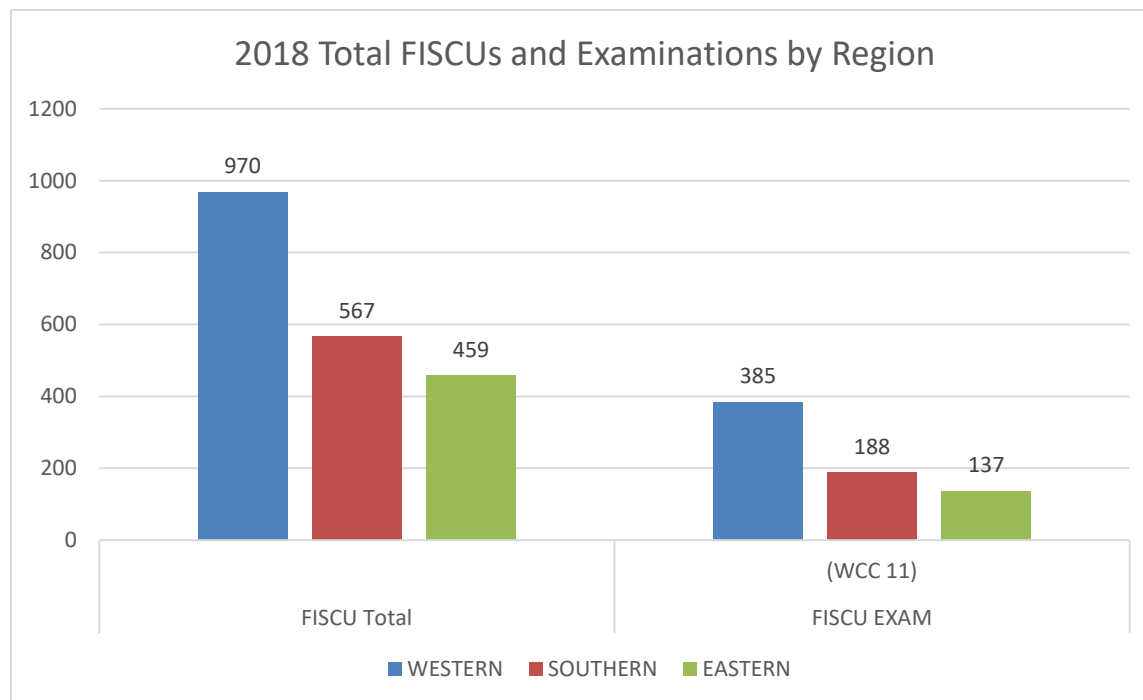


Table 2

FISCU Activity by Region			
REGION	FISCU COUNT	FISCU EXAM (WCC 11)	FISCU Review (WCC 26)
1	417	140	311
2	167	47	136
3	376	106	307
4	781	303	576
5	255	114	194
8 (ONES)	3	2	3
Total	1999	712	1527

As shown in Chart 1 below, going forward under the new regional structure, the NCUA's Western Region has the largest number of FISCUs and accordingly will conduct more FISCU examinations than the other two regions.

Chart 1



Note: This chart does not include three FISCUs that ONES oversees and two examinations completed by ONES for FISCUs in 2018.

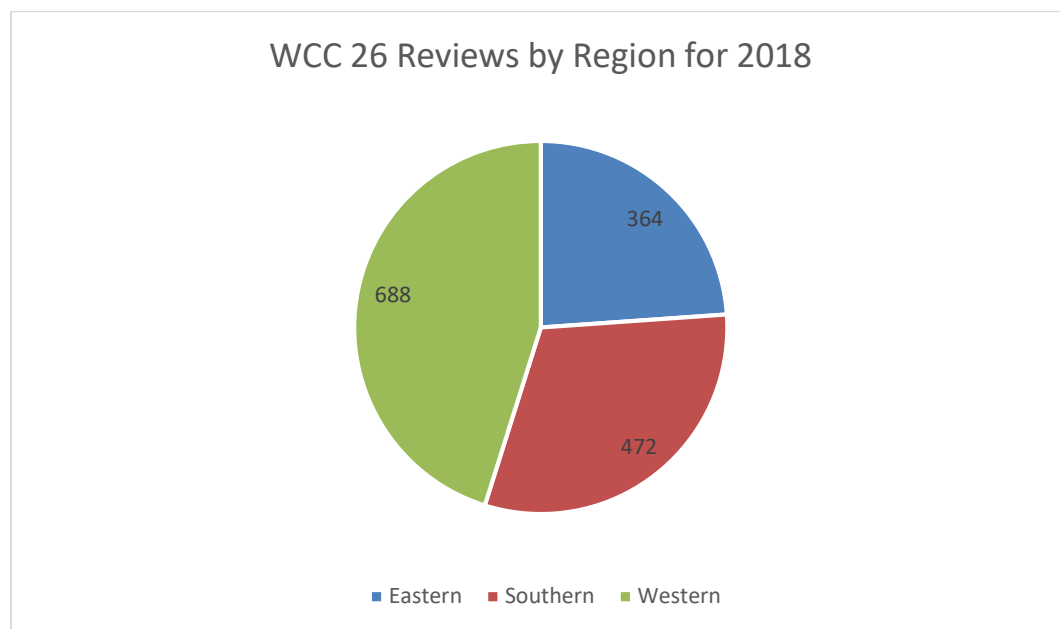


WCC 26 Reviews

In accordance with the NSPM, NCUA examiners must conduct a review of all SSA examinations, regardless of whether the NCUA participated in a joint examination. The work code for these reviews is WCC 26. For reviews of joint examination SSA reports, NCUA examiners charge their time to WCC 26 and must ensure the SSA's final report included all of the concerns identified and discussed with the SSA while on-site. The WCC 26 code is also used by NCUA examiners for SSA examination report reviews that were done without participation by the NCUA. In these cases, where the NCUA did not directly participate in an SSA-only FISCO examination, examiners charge their time to the same work classification code, WCC 26.

As shown in Chart 2 below, during 2018, what is now the Western Region conducted the majority (688) of the 1,527 WCC 26 reviews. See Table 2 above for a breakdown of the previous organizational structure that included five regions and ONES.

Chart 2



Note: This chart does not include 3 WCC 26 examinations conducted by ONES in 2018.⁹

Information Sharing Agreements

In December 2013, the NCUA issued Instruction No. 13500.11 regarding the sharing of nonpublic NCUA information with SSAs. The instruction referenced a new standardized Information Sharing Memorandum of Understanding (MOU) that the NCUA required be executed with SSAs to replace regional offices' separate information sharing agreements and

⁹ In 2018 the NCUA operated with 5 regional offices, this information is put into the current organizational format reflecting the 3 regional offices.



most nondisclosure agreements. The instruction also provided an Information Sharing Summary Matrix, which clarified what pertinent information NCUA examiners could share with SSAs.

Exam Flexibility Initiative

In May 2016, the NCUA board approved the formation of an Exam Flexibility Initiative (EFI) with the goal of improving the NCUA's ability to adapt to economic changes and emerging issues while ensuring staff had the resources needed to appropriately examine and supervise credit unions. Based on an EFI recommendation, in February 2017, the NCUA formed the NCUA-State Supervisor Working Group to identify and address any issues that could positively impact the joint supervision programs of the NCUA and SSAs, including improving coordination between SSAs and the NCUA in the joint examination process of FISCUs. The working group implemented a pilot program to alternate the lead supervisory authority on joint examinations with three different options:

- **Alternating lead:** The NCUA and state regulators conduct joint examinations of federally insured, state-chartered credit unions, alternating which agency serves as lead each cycle.
- **Alternating with limited participation:** The NCUA and state regulators alternate conducting examinations with some involvement from the other agency.
- **Alternating:** The NCUA and state regulators alternate conducting examinations independently.

The pilot began on January 1, 2019, and will run for approximately three years. The working group also developed a new template for an optional standardized operating agreement between the NCUA and the SSAs.



RESULTS IN DETAIL

The objectives of our audit were to determine: 1) whether the NCUA provided shared oversight of FISCUs to assess their condition and address material risks that may negatively affect the Share Insurance Fund; and 2) determine whether the NCUA effectively monitored FISCUs using off-site monitoring tools and joint oversight processes with SSAs. Our audit determined that the NCUA provides shared oversight of FISCUs and the NCUA effectively monitors FISCUs using off-site monitoring tools (including WCC 26 reviews). Although we found the NCUA has met our objectives, we determined the following areas of its joint examination process with SSAs need improvement. Specifically, 1) the NCUA's optional operating agreements with SSAs need updating, 2) NCUA management should review and revise its guidance for WCC 26 reviews, and 3) SE decisions regarding follow-up actions recommended by examiners after completing WCC 26 examination reviews should be consistently documented to create an audit trail to show SE decisions regarding examiner recommendations. The detailed results of our audit follow.

**Optional SSA
Operating
Agreements
Need Updating**

We determined that NCUA's regional offices did not have updated optional operating agreements with SSAs that defined roles and responsibilities at a high level for joint on-site examinations of FISCUs. NSPM Chapter 15 (Version 8.0) states:

Each region maintains an operating agreement with each individual state. The operating agreements outline the method and procedures to monitor FISCUs for insurance risk. Regions will document any changes to procedures or any special arrangements made with an individual state in an addendum that NCUA's Office of General Counsel will review.

In addition, the NSPM states: "The RD [Regional Director] or designated ARDP [Associate Regional Director, Programs] will meet with the SSA at least once per year. Meetings will focus on the operating agreements, discussing roles, responsibilities, and expectations for the NCUA and the SSA."

We determined that RDs and ARDs meet at least annually with the SSAs to discuss items based on the needs at that time and have continuous contact throughout the year as needed. We also determined the NCUA had signed and dated operating agreements during the period from March 2003 to July 2008. Specifically, we learned that of the 45 states that have FISCUs, 18 had signed operating agreements on file, 11 had unsigned operating agreements on file, and 16 had no operating agreement on file. Five states and the District of Columbia, Guam, Puerto Rico, and the Virgin Islands do not have FISCUs.

As a result of the NCUA not having updated and useable optional operating agreements with each SSA, some NCUA examiners and officials we interviewed, as well as some examiners and officials for the SSAs, expressed there could be confusion regarding roles and responsibilities at a high level and indicated that although optional, having an executed operating agreement in place would help bring consistency to the working relationship and across the joint examination process.



Challenges to Implementing a Universal Operating Agreement

NCUA regions entered into operating agreements during the period from March 2003 to July 2008 to establish common understanding for communication and working relationships with SSAs when examining FISCUs. NCUA management officials told us that a former NCUA Chairman advocated for the establishment of a universal operating agreement with SSAs. The effort was challenged by the need to represent many disparate priorities and interests between the NCUA and the numerous SSAs. Because of these challenges, the effort was tabled for further engagement at a later date while NCUA management focused their efforts on a different priority, the development and implementation of a standardized information sharing agreement with each SSA.

As previously mentioned, in December 2013, NCUA management issued Instruction No. 13500.11, which established NCUA policy and guidelines on sharing nonpublic NCUA information with SSAs. The information sharing agreement stated in part: “[T]his Agreement represents the entire and integrated Agreement between the Parties and supersedes all prior negotiations, representations, or contracts, either written or oral, which relate to the Parties’ relationship.” During our audit, we learned the NCUA had entered into standardized information sharing agreements with each of the 45 SSAs that have FISCUs. These new agreements superseded the outdated operating agreements that had been signed back in the 2003–2008 time period.

Current Progress

Prior to our audit, the NCUA-State Supervisor Working Group began development on a template for the updated optional operating agreement. Although outside the scope of our audit, on June 4, 2019, the Director of E&I issued a memorandum to all RDs instructing them to:

- Send out the operating agreement template to the SSAs.
- Determine which SSAs would like to enter into a new/updated operating agreement.
- Coordinate with the SSAs to customize the operating agreement.
- Have OGC review the final draft operating agreement.
- Execute the final operating agreement.
- Send the signed operating agreement to E&I.

As of the date of this report, E&I has received one signed operating agreement with an SSA. The regions continue to work with the other interested SSAs to complete the process. We spoke with six SSAs, and have every indication from the SSAs and E&I officials we spoke with that the use of operating agreements is favored and would be something both parties are interested in entering into. In addition, subsequent to our discussions with E&I officials, they issued version



9.0 of the NSPM on September 27, 2019, which included the following provision: “[i]f the region has executed an operating agreement with a state, it will be maintained by the region.” We believe this makes clear that although operating agreements are not mandatory, if an NCUA regional office enters into an agreement with an SSA, the RD is responsible for keeping the agreement updated as needed, not the SSA.

This is supported by E&I management and SSA officials who both told us that they believe updated operating agreements would be beneficial to the working relationship at a high level between the NCUA and the SSAs. We believe such high level agreements would not only improve coordination, scheduling, and overall consistency of joint examinations, but would also reduce redundancy thus making the joint examination process more efficient.

During our audit, E&I officials provided us with information to document that many SSAs have operating agreements in process with the regions and that one region (Western) has an operating agreement that has been finalized and in place. In accordance with their guidance, regional offices will control and maintain the final approved optional operating agreements they enter into with the individual SSAs, and E&I will maintain an inventory of all operating agreements across all three regions at headquarters. Because NCUA management started this initiative outside the scope period of our audit and they are already taking action to enter into operating agreements with interested SSAs, we are not making recommendations at this time.

**Revisions to
Guidance Needed for
WCC 26 Reviews**

We determined there is a reluctance on the part of NCUA examiners to request additional time to complete WCC 26 reviews. In addition, we found that NCUA management might not have provided adequate guidance or necessary clarification for WCC 26 reviews of FISCUs for joint examinations with SSAs.

Specifically, NCUA management has established the expectation with examination staff that when they participate on a joint examination with an SSA, one hour is a sufficient amount of time for examiners to conduct a thorough WCC 26 review. NCUA management explained this is because the examiner has been on-site throughout the examination with the SSA and therefore they know the issues and only need to make sure the SSA’s final report communicates the issues that were agreed to by both the NCUA and the SSA.

The NSPM states: “[f]ield examiners typically have up to three hours to conduct WCC 26 reviews of the SSA report.” The NSPM does not specify whether the three hours are only for when the NCUA has not been involved in the SSA examination. In contrast, the NCUA’s annual Resource Budget Program Memorandum states, “[f]or WCC 26 reviews, examiners budget three hours for each FISCU examined by the SSA, independent of NCUA, and one hour for each FISCU receiving a joint examination where NCUA examiners participate with the SSA.” Our audit found that examiners generally only charged one hour to conduct a WCC 26 review when they participated in a joint examination, consistent with the Resource Budget Program Memorandum limitation. However, we also found that examiners are reluctant to ask for additional time for these reviews, even when they believe they need more time. This occurred for a number of reasons including:



- Not wanting to exceed the budgeted hours; or
- A lack of clarity in the guidance for examiners on requirement differences between SSA-only examinations and joint examinations.

As a result, the NCUA could be understating the amount of time NCUA examiners spend working on WCC 26 examination reviews.

During our audit, we interviewed examiners and SEs¹⁰ regarding WCC 26 reviews. Some individuals told us that in their view, the one hour time allotment for joint examination WCC 26 reviews was not enough time to complete the review. We asked the examiners who told us this if they asked their SE for additional time when conducting these reviews. Examiners expressed they did not, with several noting that asking for additional time to complete a joint examination WCC 26 review is something that is not done, adding that they work within the one hour parameter and either meet it, or make up for it somewhere else. We understood this to mean that if examiners go over the allotted one hour, they capture their additional time under different WCCs. In addition, one examiner we spoke with said it would be helpful if E&I management could provide additional guidance on when they [management] believe it is appropriate to ask for additional time to complete joint examination WCC 26 reviews.

Although we determined that examiners are sometimes reluctant to ask their SE for additional time to complete a WCC 26 review of a joint examination, we identified guidance that does address the need for additional examination time, an MOU between NCUA and the National Treasury Employees Union and the NSPM. Although not directly related to WCC 26 reviews, we found one example of many within the NSPM that allows examiners to pursue additional time as follows: “[e]xaminers will consult with their supervisor during the year if conditions warrant changes to the examination budget.” We believe this statement in the NSPM gives examiners who need more time to complete their examinations the authority to consult with their SE for the additional time should conditions warrant exceeding the Resource Budget.

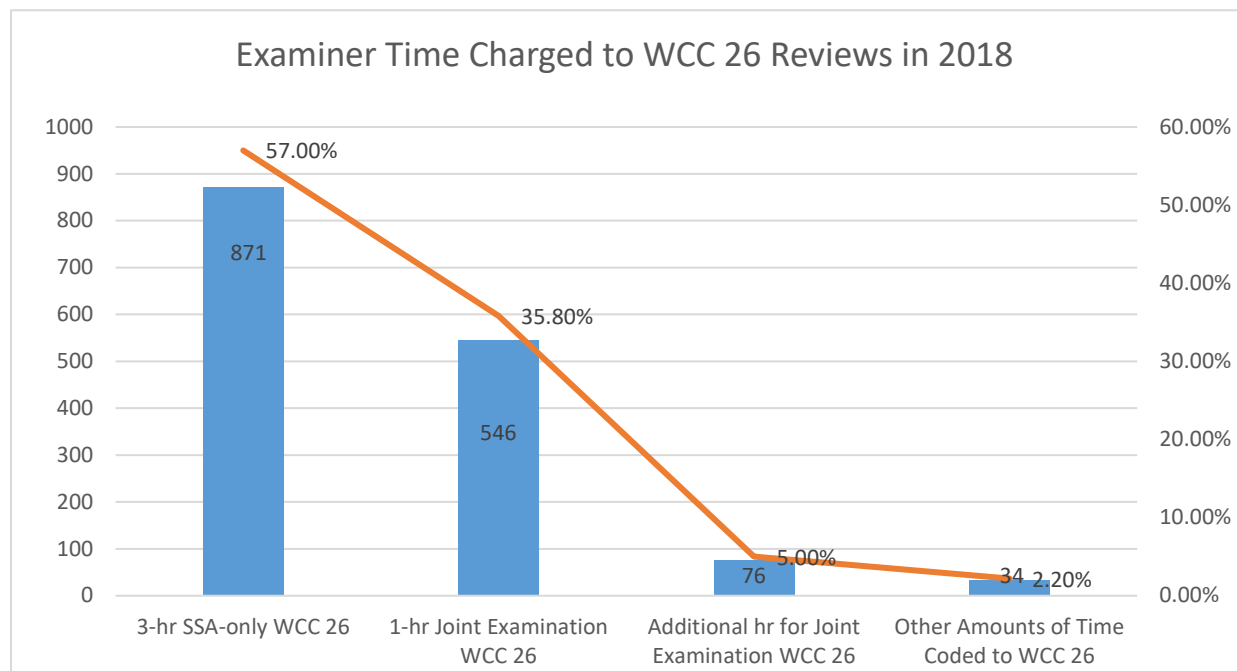
However, we determined there is no mention in the NSPM that examiners can consult with their SEs and be granted additional hours specific to completing a WCC 26 review. In fact, the only mention of timeframes we could find in the NSPM was related to the number of *days* examiners have to complete a review and not the number of *hours* they should complete the reviews in. We asked E&I officials about this and were told they are aware that the NSPM is silent on the differences in hours between WCC 26 reviews of joint examinations and SSA-only examinations and the number of hours management expects examiners to take to complete either one.

We asked E&I officials to run a report for us showing the number of hours examiners reported under WCC 26 for 2018. Chart 3 (below) provides this information.

¹⁰ We interviewed 11 examiners and seven SEs from NCUA's three regions.



Chart 3



As previously discussed in the Background section of this report, NCUA examiners completed 1,527 WCC 26 reviews in 2018. As shown in Chart 3, approximately 93 percent of the time (57 and 35.8), examiners reported either one hour (joint examination) or three hours (no NCUA involvement in the SSA examination) for WCC 26 reviews. The report also showed that examiners reported two hours for WCC 26 reviews five percent of the time and approximately two percent of the time claimed an amount presumably greater than three hours.

As previously mentioned, examiners are budgeted one hour to complete joint examination WCC 26 reviews to identify financial and operational risks in FISCUs. The NSPM requires examiners to review all state examinations, regardless of whether the NCUA participated with the SSA or not. Examiners conduct these reviews of the SSA's examination report in AIREs, which includes completing an eight question questionnaire. If the NCUA participated on a joint examination, NCUA examiners are expected to ensure all agreed upon items are contained in the SSA's final report of examination. However, the NSPM does not distinguish between the types of WCC 26 examinations. According to the NSPM, when completing a WCC 26 review, regardless of whether or not they participated in the joint examination, NCUA examiners will:

- Determine whether the report identifies and addresses material issues;
- Identify and document the SSA's and the NCUA's supervision efforts;
- Determine the appropriateness of the SSA's supervision; and
- Determine any CAMEL differences.



The NSPM requires examiners to document whether any material issues or agreed-upon concerns were addressed in the final report for a joint examination.

During our audit, NCUA management proactively made revisions to the NSPM and issued version 10 on December 6, 2019. Included in version 10 were the following two revisions made to correct issues we identified in our report. Specifically, management: 1) eliminated all references of hours to complete a joint examination WCC 26 review to ensure consistency across all NCUA instructions, manuals, memorandums, and other guidance regarding time allotments; and 2) clarified the scope of work examiners need to accomplish when conducting both a joint examination WCC 26 review and when they conduct a review of an SSA-only WCC 26 review to ensure examiners clearly understand the necessary scope of work for each type of review.

We believe these revisions provide clarity to examiners and will help eliminate their reluctance to consult with their SE about the need for additional time. Because NCUA management was proactive and made these revisions to the NSPM prior to the issuance of our report, we are not making recommendations at this time.

**Consistent
Documentation of
Decisions on Follow-
Up Actions Needed**

We determined that SE decisions on follow-up actions recommended by examiners after completing WCC 26 reviews were not consistently documented. In addition, we found no guidance in the NSPM or any other NCUA document that requires SEs to document their decisions. We consider it a prudent and sound practice to consistently document SE decisions regarding examiner recommendations. Doing so would ensure that examiners' supervisory concerns would be consistently communicated and addressed. As a result of SEs not consistently documenting their decisions and actions taken or planned, examiners assigned or being assigned to a credit union may not readily understand the SEs approved supervision plans and rationale behind them.

During our interviews of NCUA examiners and SEs, they explained that SE decisions regarding follow-up to recommendations are not required to be documented. Examiners stated that after they made recommendations to address concerns stemming from their WCC 26 reviews, they did not always know the status of their recommendations because their SEs did not always inform them of their decisions. We learned that on occasions when SEs did inform the examiners, some examiners stated that they documented the decision by notating it or uploading the email that contained the SE's decision as an attachment to the examination file. Although we determined that SE decisions can be documented in SE RATE Review comments or during the annual budgeting cycle process, these processes are outside of the WCC 26 review process and do not look at the entirety of WCC 26 reviews conducted for the year. Although NCUA does not require SEs to document their decisions, E&I officials agreed there should be an "audit trail" indicating SE decisions regarding examiner recommendations.

Although outside the scope of our audit, we recently learned from E&I officials that they are making updates to the NSPM to address this and have developed an updated draft Confidential



Section that will have a place to document SE approvals or denials and be included in AIRES. We were also informed that MERIT should have the capability to capture SE decisions from examiner recommendations. Examiners will be able to document their SE's decisions within this section, which will include among other documentation, copies of emails indicating SE (or ARD) concurrence. We also learned that this section will be used to document any deviations from the NSPM. We believe this section will provide more information and the audit trail that is needed to document SE decisions regarding follow-up actions recommended by examiners. At the time of this report this effort was still in the development stage, therefore we are making the following recommendation.

Recommendation

We recommend NCUA management:

1. Create a formal process to capture supervisory examiner decisions regarding recommended follow-up actions taken or not taken from work classification code 26 reviews to ensure concerns identified by examiners are properly documented.

Management Response

Management agreed with the recommendation and indicated they will implement a formal process that addresses the recommendation. Management also stated their intention is to use MERIT as the formal process and in the interim they have implemented steps to adjust the documentation process. Management anticipates completing the implementation of this process by December 31, 2020.

OIG Response

We concur with management's planned actions.



Appendix A

OBJECTIVE, SCOPE, AND METHODOLOGY

We developed our objectives for this engagement based on OIG's 2018 Annual Performance Plan. Specifically, our objectives were to:

- Determine whether the NCUA provides shared oversight of FISCUs to assess their condition and address material risks that may negatively affect the Share Insurance Fund; and
- Determine whether the NCUA effectively monitors FISCUs using off-site monitoring tools and joint oversight processes with SSAs.

To accomplish our audit, we performed fieldwork with the NCUA's Central Office in Alexandria, VA and the three regional offices, Eastern, Southern, and Western. The scope of this audit focused on all federally insured state-chartered credit unions supervised by the NCUA from January 2013 to December 2018. To achieve our objectives, we:

- Reviewed NCUA's examination files for FISCUs in AIRES.
- Reviewed E&I's reports for budget, hours for exams, and various agreements.
- Reviewed applicable policies and procedures for FISCUs.
- Reviewed laws applicable to E&I's review of FISCUs.
- Reviewed GAO's Standards for Internal Control in Federal Government, dated September 2014.
- Reviewed the NCUA's Exam Flexibility Working Group minutes and presentations.
- Reviewed the NSPM and Examiner's sections related to oversight of FISCUs.
- Obtained examples of the E&I reports, files, and examinations.
- Interviewed E&I staff (examiners and SEs), senior management, and executive management involved in the oversight of FISCUs.
- Interviewed SSA officials from six states that have FISCUs.

We used computer-processed data from NCUA's AIRES and NCUA online systems. We did not test controls over these systems; however, we relied on our analysis of information from



management reports, correspondence files, and interviews to corroborate data obtained from these systems to support our audit conclusions.

We conducted this audit from June 2018 through December 2019 in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

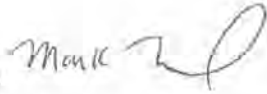


NCUA MANAGEMENT RESPONSE



National Credit Union Administration
Office of the Executive Director

SENT BY EMAIL

TO: Inspector General Jim Hagen
FROM: Executive Director Mark Treichel 
SUBJ: Management Response – Audit of the NCUA's Joint Examination Process with the State Supervisory Authorities
DATE: December 18, 2019

The following is our response to the recommendation set forth in the Office of Inspector General's draft report titled "Audit of the NCUA's Joint Examination Process with State Supervisory Authorities." We agree with the recommendation.

OIG Report Recommendation: Create a formal process to capture supervisory examiner decisions regarding recommended follow-up actions taken or not taken from work classification code 26 reviews to ensure concerns identified by examiners are properly documented.

Management Response: By December 31, 2020, we will implement a formal process that addresses the recommendation. Our intention at this time is to use MERIT as the formal process. In the interim, we have adjusted the documentation process in the December 6, 2019 release of the National Supervision Policy Manual (NSPM). The NSPM includes a requirement for examiners and supervisors as follows:

If recommending an onsite examination or contact, the examiner will e-mail the recommendation to the supervisor. The supervisor will respond by e-mail noting agreement or disagreement with the recommendation.

Additionally, examiners can include any supervisor approvals or disapprovals in the Confidential Section.

Thank you for the opportunity to review and comment on the report. Please contact my office if you have any questions.

1775 Duke Street – Alexandria, VA 22314-6113 – 703-518-6320



ACRONYMS AND ABBREVIATIONS

Acronym	Term
AIRES	Automated, Integrated, Regulatory Examination System
ARD	Associate Regional Director
CAMEL	<u>C</u> apital Adequacy, <u>A</u> sset Quality, <u>M</u> anagement, <u>E</u> arnings, and <u>L</u> iquidity/Asset-Liability Management
CO	Central Office
E&I	Office of Examination and Insurance
FCU	Federal Credit Union
FISCU	Federally Insured State-Chartered Credit Union
FICU	Federally Insured Credit Union
NCUA	National Credit Union Administration
NSPM	National Supervision Policy Manual
OGC	Office of the General Counsel
OIG	Office of Inspector General
ONES	Office of National Examinations and Supervision
RD	Regional Director
RFE	Risk-Focused Examination
SCUEP	Small Credit Union Examination Program
SE	Supervisory Examiner
SIF	Share Insurance Fund
SSA	State Supervisory Authority
WCC	Work Classification Code