

NATIONAL CREDIT UNION ADMINISTRATION
OFFICE OF INSPECTOR GENERAL

LOW INCOME CREDIT UNION
GRANT AND LOAN REVIEW

Report #OIG-08-05
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A handwritten signature in black ink, reading "William A. DeSarno".

William DeSarno
Inspector General

Released By:

A handwritten signature in black ink, reading "James Hagen".

James Hagen
Assistant Inspector General for Audits

Auditor-in-Charge:

A handwritten signature in black ink, reading "Charles E. Funderburk".

Charles E. Funderburk, CPA
Senior Auditor

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EXECUTIVE SUMMARY

The National Credit Union Administration (NCUA) Office of Small Credit Union Initiatives (OSCU) administers the Community Development Revolving Loan Fund (CDRLF or Fund). The CDRLF offers financial assistance through loans and Technical Assistance Grants (TAGs or grants). Congressional appropriations and income derived from the loans fund the CDRLF program. Federal and state chartered, low income designated credit unions may participate in CDRLF programs. As of December 31, 2006 there were 8,362 Federally insured credit unions. Of those, 1,053 are designated low income credit unions and were eligible to apply for CDRLF assistance.

The NCUA Office of Inspector General (OIG) performed a review to determine the following: (1) how loan and TAG funds under the CDRLF program are awarded; (2) whether the loans and grants are awarded competitively; and (3) whether the loan and grant program contingencies are being met. We sampled 10 of 70 CDRLF loans outstanding, as of December 31, 2006, and 30 of 402 TAGs awarded in 2006.

In addition to meeting basic eligibility standards, both CDRLF loan and grant applicants must meet additional regulatory and statutory criteria and provide specific information to qualify as award participants. OSCUI staff analyzes the applications to ensure that standards and criteria are met. In the cases we reviewed, all participating credit unions that received loan and grant awards met the requisite eligibility requirements. Subsequent to the award of a CDRLF loan or grant, participating credit unions must file annual progress reports; subsequent to the award of a CDRLF grant, participating credit unions must file an outcome summary report and an expense reimbursement request upon completion of the award project.

Although we found that both the CDRLF loan and TAG programs generally meet the objectives of the CDRLF, we identified some areas where improvement could be made. The areas for improvement were concentrated in the award application and analysis process and in the post award monitoring of CDRLF loans and grants.

BACKGROUND

The OSCUI administers the CDRLF. The Fund offers loans and TAGs, and receives its funding from congressional appropriations and accumulated earnings. Federal and state chartered, low income designated credit unions may participate in these programs. As of December 31, 2006, there were 8,362 federally insured credit unions. Of those, 1,053 were designated low income credit unions which were eligible to apply and compete for CDRLF assistance.

The table below depicts the funding history of the CDRLF:

Fiscal Year	Appropriated	Appropriated	Approved	Approved
	Loans	Grants	Loans	Grants
1979 to 1996	\$6,000,000	\$0	\$16,400,000	\$696,000
1997	1,000,000	0	2,261,000	215,461
1998	1,000,000	0	2,365,000	357,224
1999	2,000,000	0	1,900,000	343,549
2000	1,000,000	0	5,583,000	292,729
2001	650,000	350,000	2,657,000	369,815
2002	650,000	350,000	3,259,000	668,044
2003	700,000	300,000	1,004,997	460,242
2004	200,000	1,000,000	1,797,458	1,225,565
2005	200,000	800,000	1,669,000	949,219
2006	0	950,000	4,214,000	1,371,130

The **CDRLF loan program** is intended to support low income credit unions in:

- Providing basic financial and related services in their communities;
- Stimulating economic activities in communities resulting in increased income, and ownership and employment opportunities for low income residents; and
- Assisting credit unions in delivering financial services and improving their long term growth and stability.

Loans are limited to a maximum of \$300,000 per credit union with a fixed maximum interest rate of three percent and a minimum rate of one percent, as determined by the NCUA Board. Loans issued after January 1, 2002, carry a fixed rate of one percent. Interest and principal are repaid on a semiannual basis beginning six months and one year, respectively, after the initial distribution of the loan. The maximum loan term is five years. Participating credit unions may be required to match the value, in shares, of the loans within one year of the date of the loan. Loans may be recorded as a note payable or a non-member deposit on the credit union's accounting records, at the discretion of the NCUA. Loans recorded as a note payable may be collateralized. The loan fund operates as a revolving loan fund; that is, as credit union loans are paid off, the proceeds are available to make new loans.

The CDRLF TAG program is intended to assist credit unions in providing better services to members by:

- Improving the quality of service to members;
- Making low income credit union operations more efficient; and
- Stimulating economic activities in the communities served.

TAG appropriations are for a two year, September 30th fiscal year end cycle. TAG awards, however, are made within a one year period. In 2006, OSCUI established six grant initiatives. OSCUI budgets a certain amount of total grant funds to each initiative. The following are the six technical assistance grant initiatives OSCUI designated in 2006:

- **Building Internal Capacity** – designed to provide funds for projects that improve the overall operations or financial condition of the credit union, and ultimately enable the credit union to better deliver services to its members. This grant had two opening and closing application dates with a maximum of \$3,500 and \$5,000 per grant in the respective application periods.
- **Outreach Partnering** – designed to provide funds for projects that provide new or better services to existing members and those projects which will extend services to potential members and the community. This grant had an opening and closing application period with the maximum grant amount set at \$10,000.
- **Urgent Needs and Disaster Recovery** – designed to ensure the continued growth and viability of a credit union with an immediate and pressing need for improving its financial conditions or operations. This grant is open year round with a maximum grant amount of \$3,000.
- **Staff, Official, Board Training** – designed to provide funds for training staff, officers and board members of credit unions that will help improve the operations or financial conditions of the credit union, and ultimately enable the credit union to better serve its members. This grant had an open and closing application period with a maximum grant amount of \$3,000.
- **Voluntary Income Tax Initiative** – designed to provide financial assistance to credit unions wishing to help existing and potential members prepare their tax returns. This grant has an open application date and a closing date when funds are exhausted for this initiative. The maximum grant amount was \$2,500.
- **Student Internships** – designed to provide low income credit unions an opportunity to introduce college students to credit unions and credit union operations, in order to potentially recruit and develop the next generation of credit union managers. This grant has an open application date and a closing date when funds are exhausted for this initiative. The maximum grant amount was \$6,000.

In addition to administering the CDRLF, OSCUI provides the following to small, new and low income credit unions:

- Direct Assistance through NCUA Economic Development Specialists (EDS);
- Training via workshops; and
- Partnering opportunities with various governmental agencies and nongovernmental organizations to identify and share innovative initiatives.

PURPOSE AND OBJECTIVES

The purpose of this review was to obtain an understanding of the Office of Small Credit Union Initiatives. Our objectives were to:

1. Determine how CDRLF loan and grant funds are awarded;
2. Determine if the loans and grants are competitively awarded; and
3. Determine if there are loan and grant program contingencies and if they are met.

SCOPE AND METHODOLOGY

The scope of the review encompassed CDRLF loans with loan balances as of December 31, 2006, and TAGs awarded in 2006.

The review procedures included review of the following:

- Regulatory guidance;
- Other agency guidance and practices regarding loan and grant award processes; and
- Sample of loan and grant awards.

Loan and Grant review process:

We reviewed the sampled loans and grants for credit union eligibility, application compliance, OSCUI award analysis, and OSCUI credit union post award monitoring.

Loan sample methodology:

As of December 31, 2006, there were 70 CDRLF credit union loans outstanding with a total cumulative balance of \$7,387,171. A judgmental sample of ten loans outstanding was selected for review with a total cumulative balance of \$1,502,100.

TAG sample methodology:

There were 402 TAGs awarded for \$1,371,130 during 2006. These grants comprised six separate grant initiatives established by the agency. A judgmental sample of five grant awards per initiative was selected for review, for a total of 30 grants. The total sampled TAG awards amounted to \$125,502. The following is the sample selection methodology for each of the six grant initiatives:

1. **Building Internal Capacity Grants.** Of the 195 Building Internal Capacity grants awarded in 2006, amounting to \$725,996, we selected for review a judgmental sample of five grant awards, amounting to \$18,467.
2. **Urgent Needs/Disaster Recovery Grants.** Of the 33 Urgent Needs/Disaster Recovery grants awarded in 2006, for a total of \$83,326, we selected for review a judgmental sample of five grant awards, for a total of \$17,000

3. **Outreach and Partnering Grants.** Of the 33 Outreach and Partnering grants awarded in 2006, amounting to \$220,139, we selected for review a judgmental sample of five grant awards totaling \$38,064.
4. **Staff, Official and Board Training Grants.** Of the 87 Staff, Official and Board Training grants awarded in 2006, for a total of \$117,850, we selected for review a judgmental sample of five grant awards for \$9,714.
5. **Student Internship Grants.** Of the 23 Student Internship grants awarded in 2006, for a total of \$57,500, we selected for review a judgmental sample of five grant awards in the amount of \$12,500.
6. **Volunteer Income Tax Assistance Grants.** Of the 32 Volunteer Income Tax Assistance grants awarded in 2006, amounting to \$166,320, we reviewed a judgmental sample of five grant awards for a total of \$29,758.

RESULTS

CDRLF LOANS

As of December 31, 2006, there were 70 CDRLF credit union loans outstanding with a total cumulative balance of \$7,387,171. A judgmental sample of ten loans outstanding was selected for review with a total cumulative balance of \$1,502,100 as of December 31, 2006. All of the sampled loans were loans awarded to federally chartered credit unions.

Eligibility

To qualify for a CDRLF loan, a credit union must be designated as a low income credit union by NCUA or the appropriate state supervisory authority. For our review, all ten sampled federally chartered credit unions were low income designated credit unions.

Loan Application

Credit unions may file CDRLF loan applications in hard copy or on-line (electronically). To qualify for a loan, a credit union must:

- Demonstrate a sound financial condition;
- Demonstrate management ability;
- Provide a recent balance sheet and income statement;
- Provide recent loan delinquency and allowance for loan loss schedules;
- Provide a UCC-1 Security Agreement, if applicable;
- Provide a matching shares agreement, if applicable;
- Provide an 18 month strategic plan; and
- Provide a community needs plan.

An OSCUI analyst reviews the applications, analyzes them, and makes a recommendation to the OSCUI Director for approval. After the OSCUI Director approves the application, OSCUI forwards the loan request to the appropriate NCUA regional office for concurrence. While final loan approval does not require regional office concurrence, all ten sampled loan approvals in our review received regional office concurrence.

Award Determinations

Two loan applications listed **operating expenses** as uses for the loan proceeds. OSCUI staff stated that loan proceeds may be used for operating expenses. In one case, the credit union intended to use CDRLF loan proceeds to expand services, add staff, and fund loans. The application did not specify to what extent the proceeds would be used for each of these endeavors.

In the second case, loan proceeds were to fund loan demand, operating expenses, and purchase a printer. The application did not specify to what extent the proceeds would be used for each. Because operating expenses tend to be a recurring expense (use of funds), it does not seem to be a prudent business practice to fund them with a five year term loan.

We realize that the CDRLF has a history of providing funding to credit unions wishing to invest CDRLF proceeds, thereby earning income (arbitrage) from their investment, achieving financial growth, and using the income to cover the costs of member basic financial services. However, the CDRLF loan proceeds should not be used to directly fund operating expenses.

RECOMMENDATION #1: OSCUI should ensure that award recipients do not use finite term CDRLF loans to fund credit union operating expenses.

Management Response: Disagree – CDRLF awards loans and establishes maturity dates to allow credit unions to minimize the financial impact of adding or improving services to members. The cost of the service will be subsequently covered by income earned from the addition of the service. Allowing credit unions to use CDRLF loans for operating expenses assists the credit union in providing financial services and improving its financial condition through arbitrage. Providing services and improving the credit union’s financial condition are within the purpose and objectives of Part 705 Rules and Regulations. Furthermore, the use of the Fund for operating expenses is not prohibited by the regulation. Using loans for operating expenses has not caused safety and soundness concerns.

OIG Response: We realize that using the loan funds is not prohibited by the rules and regulations. However it is not good business practices to use the loan funds solely for the purpose of operating expenses. Our recommendation is not addressing CDRLF funds that are invested in a program or service whereby the income generated from that program or service is used to pay for the programs expenses. We are addressing the issue where the CDRLF loan purpose and the use of funds is to directly pay for operating expenses.

RECOMMENDATION #2: Loan agreements should specify the purpose of the loan.

Management Response: Agree – The office will work with the CDRLF’s legal counsel to determine the most appropriate means for clarifying the loan purpose.

OIG Response: We agree with the action proposed.

Seven loan applications listed **funding of member loans** as the use for the CDRLF loan proceeds. However, several of these credit unions had NCUA examination issues relating to loans.

In the first case, the purpose of the loan was to lend funds to members and acquire participations in order to generate income to fund an ATM program. However, the NCUA examination revealed that the loan participation policy was rather broad. In addition, an accompanying Document of Resolution (DOR) noted problems with profitability, loan delinquency, and charge-offs with member business loans. Moreover, the CDRLF loan application did not specify what type of loans or amounts were planned for. OSCUI addressed these problems by not funding the full amount requested by the credit union.

In a second credit union, the NCUA examination noted a problem with liquidity. Specifically, it stated there was a need for a liquidity contingency plan. However, the credit union's application for the CDRLF loan did not address this issue.

In a third credit union, the NCUA examination noted that the credit union loan policy did not agree with actual loan procedures. In addition, the examination indicated that the credit union had shown negative share and loan growth, and the strategic plan lacked specific goals for the next two to three years.

In a fourth credit union, the NCUA examination showed that strategic risk was high in the credit union due to ineffective loan marketing, high operating expenses, and elevated loan charge-offs. OSCUI addressed these problems by not funding the full amount requested by the credit union, and noted that the region had upgraded this credit union to a CAMEL 2.

We recognize that prior to awarding a CDRLF loan; CDRLF conducts an independent analysis of the financial condition of the credit union and contacts the region for their review and concurrence. OSCUI management told us that in instances where the credit unions financial condition or stated funds do not support the full amount of the loan requested, CDRLF either defers the entire amount or a portion of the loan until issues are resolved. While we believe this is a good practice, we concluded that it is not a prudent business practice to award CDRLF loans to credit unions that plan to use the loan proceeds to fund member loans, when the credit unions have existing examination issues related to credit union lending programs. In addition, it is a prudent lending practice for the credit union application to specify the type and amount of loans for which it seeks funding.

RECOMMENDATION #3: Prior to awarding a CDRLF loan to a credit union, OSCUI should require the credit union to demonstrate that it has resolved any "loan purpose" (i.e. lending program) issues.

Management Response: Disagree – CDRLF's current system adequately addresses the objective stated above. Prior to awarding a CDRLF loan: 1) CDRLF conducts an independent analysis of the financial condition of the credit union, which includes reviewing the examination reports, CAMEL Codes, and Financial Performance Reports. 2) CDRLF contacts the region which has oversight responsibility for the low-income credit unions for their independent review and concurrence. 3) Region performs an

independent assessment of the credit union's current financial condition and operation, and sends a memorandum noting its concurrence or concerns with the loan.

OIG Response: The report demonstrates that loan purpose issues, in this case member loans, were not considered in a prudent manner when making CDRLF loans. It is not a good business practice to loan CDRLF funds for a credit union program or service that has unresolved examination issues related to that program or service. Our examples in this report show that it is not prudent to lend CDRLF funds to credit unions with ineffective lending policies, or that already had difficulty generating member loans and there is a problem with collections of current loans. Although management disagrees with the recommendation the actions stated in the disagreement are the corrective actions we would want to see to fix the current situation. So it appears corrective action is being taken.

RECOMMENDATION #4: OSCUI should ensure that CDRLF loan applications specify the member loan types and amounts when the stated purpose is to fund member loans.

Management Response: "Addressed in 2007"

OIG Response: The scope of our audit tested Grants and Loans that were completed at the time of fieldwork which were those issued in 2006. Management explained in a draft response to this report that "*The 2007 edition of the application includes a section that requires credit unions to indicate anticipated changes in the following areas: assets, shares, loans, member business loans, average share balances and membership. In addition, the loan application requires that the LICU describe how they will use the loan to serve the community needs. CDRLF will review the current loan application to determine the most appropriate means for expanding beyond the two loan types already noted on the loan application*". We agree with this action taken as it addresses our recommendation.

Loan applications we reviewed required credit unions to submit 18 month **strategic plans**. Three of the ten sampled credit unions submitted only one year "strategic plans". We were informed by OSCUI management that CDRLF's 2007 edition of the loan application does not require a credit union to submit strategic plans; however, it does require many elements of a business plan and it helps guide these credit unions through the process.

Credit unions are also required to submit **Community Needs Plans**. We found that five of the ten plans submitted were lacking in specifics. While these plans discussed in general what the CDRLF loan was to be used for, they were lacking in the specific dollar usages (i.e. types of loans), how the credit union plans to accomplish their objectives, and the measurement of directly related results.

At our exit conference, OSCUI management informed us that the 2007 loan application has been revised to obtain specific needed information and includes a “Community Needs” section which requires the applicant to describe the needs of the community and how the loan will serve those needs.

RECOMMENDATION #5: The credit union Community Needs plan should list specifically how the loan will be used over the life of the loan (usually five years) and project meaningful results oriented outcomes related to the specific purpose of the loan.

Management Response: “Addressed in 2007”

OIG Response: The scope of our audit tested Grants and Loans that were completed at the time of fieldwork which were those issued in 2006. Management explained in a draft response to this report that “*CDRLF has found that the term “Community Needs Plan” is not widely recognized and causes applicant confusion. Therefore, loan applications were revised in April 2007 to obtain specific needed information. The current 2007 loan application has a section “Community Needs” which requires the applicant to describe the needs of the community and how the loan will serve those needs. The loan application also has another section [Business/Strategic Plans] which describes growth goals that mirror CDRLF’s five performance measures. These five performance measures are primarily the same performance goals that OMB has accepted as performance measures/outcome goals for the CDRLF program as a whole. The CDRLF will continue to evaluate and modify the loan application to ensure that information regarding the outcome can be measured and monitored. In addition, the CDRLF will continue to receive annual loan summaries that follow-up on the credit union’s success in meeting the community’s needs*”. We agree with this action taken as it addresses our recommendation.

In reviewing a CDLRF application, OSCUI also performs an **analysis** of various credit union factors. A credit union must obtain a score of 100 out of a maximum of 180 score factors to qualify for a CDLRF loan. The following discusses the six analysis sections of OSCUI’s rating form:

- The General section lists the purpose of the loan and limits the maximum loan amount qualification based on CAMEL rating, number of years since the credit union was chartered, and the net worth ratio of the credit union.
- The Financial and Operational Capacity section rates the credit union’s net worth ratio, delinquent loan ratio, loan charge-off ratio, operating expense ratio, return on asset ratio and total loans to shares ratio. The total maximum score is 30. The maximum score may be obtained with net worth (7%+) and operating expense (4%+) ratios, when these standards are below peer (16.5%, 3.89% respectively) for all low-income credit unions.
- The Management section rates the credit union Board’s ability to manage and plan. The total maximum score is 35. Two of the ten sampled credit unions obtained high management ratings despite one having a CAMEL 3 management component and the other credit union having management DOR issues.

- The Compliance section rates the credit union’s regulatory compliance. The total maximum score is 25. One of the sampled credit unions obtained the highest rating despite having multiple DOR compliance issues.
- The Demonstrated Need section rates projected financial improvements, impact on the credit union and its members, and reason why the credit union can’t fund the project. The total maximum score is 40. The ratings for improvement and impact provide no monetary guidelines for scoring (e.g., number of new members, income generated, dividends paid etc.).
- The Outreach section rates the credit union’s loan and share types, percentage of members to total members, developmental services, partnerships with other agencies, matching fund requirements, percentage of loan and share growth, and the community needs plan. The total maximum score is 50.

We also noted that there is no analysis section that requires OSCUI to rate credit unions’ performance/compliance on previous CDRLF loans or grants. This seems to be a significant omission. In the examples above we have shown that the high score for individual categories within the current rating system is easily achievable.

RECOMMENDATION #6: The OSCUI rating system should be refined to provide meaningful distinction between scores assigned to credit unions.

Management Response: “Addressed in 2007”

OIG Response: The scope of our audit tested Grants and Loans that were completed at the time of fieldwork which were those issued in 2006. Management explained in a draft response to this report that “*CDRLF will further refine the evaluation system without causing additional resource burden during the evaluation of the loan applications*”. We agree with this action taken as it addresses our recommendation.

Monitoring

According to the signed note payable agreements that awardee credit unions execute, annual progress reports are due by June 30 of each year. Six of the ten sampled credit unions failed to file annual progress reports. Of the other four sampled credit unions, their annual progress reports lacked specifics (statistics etc.) related to the purpose of the loan.

Without annual progress reports the effectiveness of the loan programs and compliance with the loan terms can not be determined.

RECOMMENDATION #7: Enforce the requirement of filing annual progress reports and require specific outcome measures related to the loan purpose.

Management Response: “Addressed in 2007”

OIG Response: The scope of our audit tested Grants and Loans that were completed at the time of fieldwork which were those issued in 2006. Management explained in a draft response to this report that *“There is some confusion regarding the term “Community Needs Plan.” The plans were inconsistent and often did not provide the information needed. To ensure consistency and more meaningful information, CDRLF developed a standardized format as reflected in the “CDRLF Loan Summary.”* In addition, management stated *“The CDRLF will update the Loan Summary to include additional quantifiable measures and future loan agreements will be updated to eliminate the submission of documents that can be obtained from other computerized sources”*. We agree with this action taken as it addresses our recommendation.

According to the note payable agreement, a **late charge** of five percent of principal and interest will be imposed on the 11th calendar day following the CDRLF loan payment due date. No late fee was charged for three credit unions that had at least one payment 11 days past due.

RECOMMENDATION #8: Enforce the late charge requirement in accordance with the note payable agreement.

Management Response: Agree. Estimated date is early 2009. CDRLF will make changes to the late fee calculation in the loan system concurrent with the agency’s conversion to a new data processing and general ledger system.

OIG Response: We agree with the planned action.

Loan Terms

OSCUI uses a **standard loan form** for all of the CDRLF loans. Although the loan form discusses payment terms and OSCUI provides payment schedules, the loan form does not explicitly state a loan maturity date. Moreover, the CDRLF loan form does not state the purpose of the loan. Information regarding these two loan features would strengthen loan enforcement and communicate more clearly the terms of the loan.

RECOMMENDATION #9: Consider incorporating the loan maturity date and purpose of the loan into the loan agreement.

Management Response: Agree. Estimated date for action is August 2008. The office will add the loan maturity date on the credit union’s loan agreement.

OIG Response: We agree with the planned action.

The loan agreement cites NCUA Rules and Regulations relating to the requirement that the credit union **match share deposits** with the loan amount. The loan terms also state

that a loan breach occurs when there is a “. . .failure to assist in the perfection of the **security interest**. . .” OSCUI stated that starting in 2007, they no longer required the matching provision and that securing the loan was at the discretion of OSCUI. Four of the ten sampled credit unions did not require matching agreements. Nine of the sampled credit unions had unsecured loans. These two provisions appear to be prudent lending practices.

OSCUI management stated at our exit conference that making a credit union match a loan with deposits should remain an option not a requirement. If this is managements contention then it should seek revision of Section 705.7(a)(1). In addition, management believes that securing a loan should remain an option, not a requirement.

RECOMMENDATION #10: Consider reinstating the requirements for matching funds and collateralizing loans to encourage credit union self sufficiency and protection against defaulted loans.

Management response: Disagree. Management’s complete response is in the appendix of this report. In summary, management stated “Matching funds and collateralizing of loans should remain an election of OSCUI when administering the loan program. During the annual review of the loan process, and more often if needed, requiring matching funds or collateralization for CDRLF loans will be considered.” “The option of Matching Funds was developed to encourage credit unions’ self sufficiency; however, our experience shows that matching often has the opposite effect.” “CDRLF had planned to review the matching funds option for the next loan funding round, scheduled for the third quarter of 2008. During its annual review, CDRLF will revisit loan collateralization.”

OIG Response: The NUCA Rules and Regulations are written indicating that it should be a normal practice to require matching funds. Collateralizing loans is a prudent business practice to protect a lender. If management believes that matching funds is not working as intended and has the opposite effect then the NCUA Rules and Regulations should be revised to reflect the current conditions.

CDRLF Technical Assistance Grants

There were 402 grants awarded, for a total of \$1,371,130 during 2006. These grants reflected the six separate TAG initiatives established by the agency for CDRLF grants. A judgmental sample of five grant awards per initiative was selected for review, for a total of 30 grants. The total sampled grant awards amounted to \$125,502. As described in greater detail above, the following were the six grant initiatives in 2006:

- Building Internal Capacity
- Outreach Partnering
- Urgent Needs and Disaster Recovery
- Staff, Official, Board Training
- Voluntary Income Tax Initiative
- Student Internships

Eligibility

To qualify for a CDRLF TAG, a credit union must be designated as a low income credit union by NCUA or the appropriate state supervisory authority. We sampled 30 federally insured credit unions, all of which were designated low income.

Applications

Applications can be filed by credit unions in hard copy or electronic form. An OSCUI analyst reviews the applications, analyzes them, and makes a recommendation to the OSCUI Director for approval. Grant funds are disbursed to credit unions on an expense reimbursement basis. Credit unions are required to file for expense reimbursement and provide an outcome summary report by a certain date, specified in the grant award letter.

For the **Building Internal Capacity** and **Staff, Official, Board Training** initiatives, the TAG applications request information describing the project, cost of the project with attached vendor bids, how the grant will improve operations of the credit union, and how it will improve and measure the quality of financial services to members or stimulate economic activities in the community. Our review noted that one of the five sampled training grants for this initiative did not have an application or OSCUI analysis on file.

The **Outreach and Partnering** initiative grant application requests information on other entity partnering relationships in addition to the information requested (see above) for the Building Internal Capacity grant. Three out of five sampled credit unions had vendor bid amounts that did not agree with the grant proposed amounts. Two of the five sampled credit unions had performance measures that were not outcome oriented. One had very general outcomes and the other had measured outputs (number of brochures) and not outcomes (number of new members).

The grant application for the **Urgent Needs** initiative requests information describing what constitutes an immediate and pressing need to ensure the continued growth and viability of a credit union. As with the Outreach and Partnering initiative application, the Urgent Needs initiative application also requests the additional information required in the Building Internal Capacity application.

One of the five sampled applications for this initiative lacked support for the vendor bid amount. One grant was approved for worn carpet and tile replacement, which was originally disapproved by the OSCUI reviewer. The grant was subsequently approved by the OSCUI Director for \$3,500, \$500 over the stated maximum amount (\$3,000) allowed, according to the terms of the application. Another grant that was approved, for an opinion audit, was a repeat DOR item for the applicant credit union.

The **Student Internship** application requests a student intern application form, including a student resume, along with a letter from a college counselor, advisor, or dean,

indicating that the student is currently enrolled at the institution. This is in addition to the information requested on the Building Internal Capacity grant application. Two of the five sampled credit unions with TAGS for this initiative did not have a letter from the college indicating student enrollment. One credit union file had an illegible e-mail and the other had a listing of courses taken by the student. Three of the five sampled credit unions had CAMEL management component ratings of 3. While one credit union appeared to have the ability to self fund the program, this was not a grant determining criteria.

The **Voluntary Income Tax Assistance** grant application requests the credit union's Internal Revenue Service (IRS) filer number, in addition to the information requested under the Building Internal Capacity grant application. One credit union appeared to have the ability to self fund the program. Again we found that this was not considered a grant determining criteria. Two credit unions did not file their IRS filer number.

RECOMMENDATION #11: Grant awards should not be issued until all application requirements are completed.

Management Response: "Addressed in 2007."

OIG Response: The scope of our audit tested Grants and Loans that were completed at the time of fieldwork which were those issued in 2006. Management explained in a draft response to this report that "*CDRLF will review grant awards to ensure all conditions are met prior to making a disbursement.*" We agree with this action taken as it addresses our recommendation.

RECOMMENDATION #12: Grants should not be awarded unless the applicant credit union demonstrates a need for the funds (inability to self fund).

Management Response: Disagree. "Our grant guidelines provide a list of several criteria both financial and non-financial used to evaluate grant applications, as appropriate. Rarely are grants awarded based on a single criterion. Depending on the amount of grant monies requested and the amount of grant funds available, "ability to Fund" may become more or less prominent in our decision to approve the grant."

OIG Response: We still believe where competition between credit unions is involved the credit union with the greater needs should be awarded the grant. That is the basis for the program.

Award

OSCUI performs an **analysis of grant applications**. Part of this analysis includes a scoring system based upon certain financial and non-financial factors. The maximum score that can be obtained is 100. According to OSCUI, the results of the scoring system

have not generated a desired “bell curve” and, therefore, this system is not necessarily the decisive factor for an award. For instance, previous grant funding may be a more important factor depending on the availability of funds compared to the dollars applied for. OSCUI staff stated that they are still trying to refine the scoring system so that the results are more like a “bell curve”. OSCUI prepares a summary of financial and non-financial factors that summarizes the application and makes a recommendation for approval/disapproval. On some grants, this is the only analysis and does not include the scoring system analysis. It should be noted that the ratings/recommendation do not consider previous CDRLF grant or loan compliance or impact/success.

The financial section of the analysis scores CAMEL ratings, net worth ratio, delinquency ratio, and return on assets. This section accounts for 20 of the total 100 maximum points. The financial section does not consider operating expense ratios. The highest rating may be obtained for CAMEL ratings 1 through 3. The highest rating for net worth may be obtained with a net worth ratio of six percent when peer for low income credit unions is 16.5%. The highest rating for delinquency may be obtained with a delinquency ratio of seven percent, when peer for low income credit unions is 2.02%.

The non-financial section of the analysis scores management, purpose, impact, previous funding, ability to fund, and partnerships. This section accounts for 80 of the 100 maximum points. The maximum score for management can be obtained with a CAMEL composite rating of 3 in management. The purpose of the grant is scored on whether it coincides with the objectives of the CDRLF. However, it would appear that this would be more appropriate as a pass/fail criteria. Previous funding is scored, but does not necessarily reflect the decision process as discussed above. Ability of the credit union to fund the project is also scored. Again, it would appear that this may also be more appropriate to rate as a pass/fail criteria. Scores are received for credit unions which receive funds from other entities.

RECOMMENDATION #13: The OSCUI rating system should be refined to include factors OSCUI deems appropriate for rating grant applications. Once established, these factors should then be followed in the analysis and rating of the grants.

Management Response: “Addressed in 2007.”

OIG Response: The scope of our audit tested Grants and Loans that were completed at the time of fieldwork which were those issued in 2006. Management explained in a draft response to this report that *“The Office has refined the evaluation criteria several times throughout the last year. Revisions to the criteria are based on annual funding objectives, the demand for grants, availability of grant monies, experience with previous funding rounds, OMB revisions/priorities, and other internal and external factors. CDRLF will continue to refine evaluation factors and criteria for the grant rounds.”* We agree with this action taken as it addresses our recommendation.

Monitoring

Credit unions which are TAG grantees must prepare and submit to OSCUI Outcome summary reports at the end of the project. A specific date is provided, in the grant award letter for the filing of outcome summary reports and grant expense reimbursement.

Two of the five sampled credit unions for the **Building Internal Capacity** grant initiative did not file outcome summary reports.

Two of the five sampled credit unions for the **Outreach and Partnering** grant initiative did not file outcome summary reports.

Three of the five sampled credit unions for the **Urgent Needs** grant initiative did not file outcome summary reports. According to OSCUI staff, an outcome summary report is generally not requested for and Urgent Needs grant and it was not required in the grant award letter.

None of the sampled credit unions for the **Training** grant initiative filed an outcome summary report. According to OSCUI staff, it would be difficult to measure success of training.

Upon conclusion of the **Student Internship grant period**, the credit union and student must complete evaluations providing an assessment of the program. In addition, the credit union must file a certification of the business days worked. All five of the sampled credit unions with grants for this initiative completed these requirements. The purpose of the Student Internship grant is designed to provide low income credit unions an opportunity to introduce college students to credit unions and credit union operations, in order to potentially recruit and develop the next generation of credit union managers. However, OSCUI does not monitor how many student interns have entered into employment with credit unions upon graduation.

Two of the sampled **Voluntary Income Tax** initiative outcome summary reports were filed late. One was filed one day late, the other five months late. Although, OSCUI does obtain some IRS filing statistics on the program's credit unions, these are for Congressional reporting purposes and not for credit union verification purposes. However, the statistics reported by the credit unions constituted an excellent outcome summary report. These statistics reported, among other things, the number of returns filed, the amount of earned income credits, and number of new members obtained.

RECOMMENDTION #14: Require credit unions to file meaningful outcome summary reports prior to disbursing expense reimbursements.

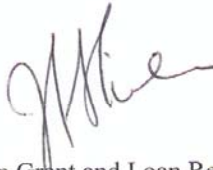
Management Response: "Addressed in 2007."

OIG Response: The scope of our audit tested Grants and Loans that were completed at the time of fieldwork which were those issued in 2006. Management explained in a draft response to this report that “*OSCUI has developed a form for credit unions to summarize the outcome of their grants, so that information is received in a consistent format, enabling the Office to store and retrieve the information from a database. Prior to 2007, the Office did not consistently require credit unions to submit a summary. For grants awarded in 2007, credit unions are required to submit summary forms at the time they request reimbursement. The Office has also begun to monitor the status of the outcome summaries through its databases. Additionally, in 2008, the Office added a paragraph to the grant application guidelines stating that credit unions not submitting summaries may be denied future grants.*” We agree with this action taken as it addresses our recommendation.

OSCUI/TYJ:pmw

VIA E-MAIL

TO: William DeSarno, Inspector General
Office of the Inspector General

FROM: J. Leonard Skiles, Executive Director
Office of the Executive Director 

SUBJ: Comment on Low Income Credit Union Grant and Loan Review

DATE: March 3, 2008

This memorandum is in response to your request for comments regarding the report "Low Income Credit Union Grant and Loan Review (Report #OIG-08-05)." We welcome this internal review of the program and appreciate the feedback. Although we are in a continual state of reviewing our program and making adjustments based on lessons learned, it only enhances our program to receive an independent view. We are pleased you find the Community Development Revolving Loan Fund (CDRLF) loan and technical assistance grant (TAG) programs generally meet the objectives of the CDRLF and look forward to adopting some of your recommendations to further enhance our program.

We noted that your review was based on 2006 CDRLF activity. We conduct reviews of the program annually; and, in 2007, made several revisions to the program. Our revisions are noted in our responses to your recommendations.

Recommendation 1. OSCUI¹ should ensure that award recipients do not use finite term CDRLF loans to fund credit union operating expenses.

Disagree.

CDRLF awards loans and establishes maturity dates to allow credit unions to minimize the financial impact of adding or improving services to members. The cost of the service will be subsequently covered by income earned from the addition of the service. Allowing credit unions to use CDRLF loans for operating expenses assists the credit union in providing financial services and improving its financial condition through arbitrage. Providing services and improving the credit union's financial condition are within the purpose and objectives of Part 705 Rules and Regulations. Furthermore, the use of the Fund for operating expenses is not prohibited by the regulation. Using loans for operating expenses has not caused safety and soundness concerns.

¹ The Office of Small Credit Union Initiatives is the administrator of the Community Development Revolving Loan Fund.

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During our annual review, and on a case-by-case basis, we will determine loan repayment based on the shortest time compatible with sound business practices and with the objectives of the program.

Recommendation 2. Loan agreements should specify the purpose of the loan.

Recommendation 9. Consider incorporating the loan maturity date and purpose of the loan into the loan agreement and adding the loan maturity date.

Agree. Estimated Date: August 2008.

The Office will work with the CDRLF's legal counsel to determine the most appropriate means for clarifying the loan purpose and adding the loan maturity date on the credit union's loan agreement.

Recommendation 3. Prior to awarding a CDRLF loan to a credit union, OSCUI should require the credit union to demonstrate that it has resolved any "loan purpose" (i.e. lending program) issues.

Disagree.

CDRLF's current system adequately addresses the objective stated above. Prior to awarding a CDRLF loan:

- CDRLF conducts an independent analysis of the financial condition of the credit union, which includes reviewing the examination reports, CAMEL Codes, and Financial Performance Reports.
- CDRLF contacts the region which has oversight responsibility for the low-income credit unions for their independent review and concurrence.
- Region performs an independent assessment of the credit union's current financial condition and operations, and sends a memorandum noting its concurrence or concerns with the loan.

Recommendation 4. OSCUI should ensure that CDRLF loan applications specify the member loan types and amounts when the stated purpose is to fund member loans.

Addressed in 2007.

Recommendation 5. The credit union Community Needs plan should list specifically how the use of the loan will occur over the life of the loan (usually five years) and project meaningful results oriented outcomes related to the specific purpose of the loan.

Addressed in 2007.

Recommendation 6. The OSCUI rating system should be refined to provide meaningful distinction between scores assigned to credit unions.

Recommendation 13. The OSCUI rating system should be refined to include factors OSCUI deems appropriate.

Addressed in 2007.

Recommendation 7. Enforce the requirement of filing annual progress reports and require specific outcome measures related to the loan purpose.

Addressed in 2007.

Recommendation 8. Enforce the late charge requirement in accordance with the note payable agreement.

Agree. Estimated Date: Early 2009.

CDRLF will make changes to the late fee calculation in the loan system concurrent with the agency's conversion to a new data-processing and general ledger system.

Recommendation 10. Consider reinstating the requirements for matching funds and collateralizing loans to encourage credit union self sufficiency and protection against defaulted loans.

Disagree.

Matching funds and collateralizing of loans should remain an election of OSCUI when administering the loan program. During the annual review of the loan process, and more often if needed, requiring matching funds or collateralization for CDRLF loans will be considered.

The option of collateralizing CDRLF loans was established to protect the Fund against defaulted loans. However, there have been no loan losses incurred during the last several years. To protect the Fund's interests, we (i) decrease the loan approval amount, (ii) defer funding, or (iii) deny the loan. The Fund also conducts a quarterly risk assessment with updates from the regions.

The option of "Matching Funds" was developed to encourage credit unions' self sufficiency; however, our experience shows that matching often has the opposite effect. Low-income members of credit unions often have limited access to deposit funds, making it difficult for the credit union to increase share balances. In order to comply with matching requirements, credit unions are often forced to meet matching requirements with rate sensitive deposits that have a negative effect on their liquidity position and earnings. In addition, rapid deposit growth can result in a drop in the net worth ratio of a credit union and could result in the possibility of Prompt Corrective Action issues for the low-income credit union.

CDRLF had planned to review the matching funds option for the next loan funding round, scheduled for the third quarter of 2008. During its annual review, CDRLF will revisit loan collateralization.

Recommendation 11. Grant awards should not be issued until all application requirements are completed.

Addressed in 2007.

Recommendation 12. Grants should not be awarded unless the applicant credit union demonstrates a need for the funds (inability to self fund).

Disagree.

Limiting grant awards to credit unions with the inability to fund their projects would limit the number of potential grant recipients to those with earnings or liquidity difficulties, thereby restricting the number of credit unions to which the CDRLF could award grants. Not awarding grants to credit unions with an ability to fund the project could also unnecessarily restrict the potential reach and community impact of CDRLF funds.

Our grant guidelines provide a list of several criteria both financial and non-financial used to evaluate grant applications, as appropriate. Rarely are grants awarded based on a single criterion. Depending on the amount of grant monies requested and the amount of grant funds available, "Ability to Fund" may become more or less prominent in our decision to approve the grant.

Recommendation 14. Require credit unions to file meaningful outcome summary reports prior to disbursing expense reimbursements.

Addressed in 2007.

Thank you for the opportunity to comment. If you have any questions, please contact me.