

NATIONAL CREDIT UNION ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

**NCUA's Risk-Focused Examinations
Tracking Identified Documents of
Resolution (DOR) Survey Report**

Report #OIG-07-06

July 10, 2007



William A. DeSarno

**William A. DeSarno
Inspector General**

Released By:

James W. Hagen

**James W. Hagen
Assistant Inspector General for Audits**

Auditor-in-Charge:

Dwight B. Engelrup

**Dwight B. Engelrup, CPA
Senior Auditor**

TABLE OF CONTENTS

	Page
EXECUTIVE SUMMARY	1
BACKGROUND	3
PURPOSE AND OBJECTIVES	4
SCOPE AND METHODOLOGY	4
RESULTS	5
APPENDIX A – MANAGEMENT COMMENTS	8

EXECUTIVE SUMMARY

In its Strategic Plan (2006-2011), the National Credit Union Administration (NCUA) states as its first strategic goal (Goal 1) “A safe, sound and healthy credit union system.” Goal 1 stems from the premise that a safe, sound and healthy credit union system, as part of the national economic structure, is necessary to stabilize the credit structure of the United States. Because of the importance of this goal, in 2006 the NCUA Office of Inspector General (OIG) conducted a review of the risk focused examination (RFE) process at NCUA (report # OIG-06-08). The RFE process is a key tool used by examiners in achieving Goal 1. As a result of the 2006 review, the OIG provided one recommendation to the agency regarding Documents of Resolution (DOR), with which the agency agreed.¹ This survey report follows-up on our prior RFE review. Specifically, we evaluated the process in place to identify, track and correct deficiencies identified by examiners in DOR during supervision and examination contacts at Federal credit unions (FCUs).²

We reviewed a judgmental sample of 25 FCUs, five credit unions from each of the five NCUA regions that had at least one outstanding (open) DOR. We concluded that for the 25 DORs we sampled, NCUA examiners were monitoring in a timely manner the progress of the FCUs to address and resolve the deficiencies noted in the DOR. We based our conclusion upon reviews of examiner work papers and NCUA monitoring reports.

We also reviewed a judgmental sample of 25 FCUs —again, five credit unions from each of the five NCUA regions-- with at least one closed or resolved DOR. Based on this sample, we found that in 23 of the 25 instances, FCUs closed the DOR in accordance with the DOR resolution date. In one case, the DOR was no longer applicable and, one DOR was not closed in accordance with the resolution date. The number of months between problem identification and closure of the DOR was approximately ten months. We based our conclusion upon reviews of examiner work papers and NCUA monitoring reports.

The NCUA Office of Examination and Insurance (E&I) informed us that the agency had developed and implemented a national tool for monitoring contact and DOR information called the AIREX Exam Management Console – Online. Additionally, E & I was in the process of developing, testing, and implementing five on-line DOR monitoring reports that will work outside of the AIREX system.

Based on information we received about agency work in progress for supervision contacts and DOR monitoring, and the results of our review to date, the OIG does not have recommendations to the agency for improvement at this time. We may revisit this area in the future to assess the additional controls being implemented by the new on-line management tools.

¹ Specifically, the recommendation stated as follows: “NCUA should clarify examiner guidance regarding the assignment of CAMEL1 composite ratings in relation to the development of Documents of Resolution for Federal Credit Unions.” In agreeing with this recommendation, the Office of Examination and Insurance indicated that it was in the process of drafting a revision to the CAMEL Rating System Letter to Credit Unions that would significantly update the process.

² For purposes of this review, we sampled only federally regulated/insured credit unions; our review did not encompass state regulated credit unions.

We have reviewed management comments and incorporated where appropriate in the report. The entire management response can be found in appendix A of this report.

BACKGROUND

NCUA's mission is to "facilitate the availability of credit union services to all eligible consumers, especially those of modest means, through a regulatory environment that fosters a safe and sound credit union system." Among the outcomes NCUA hopes to achieve through realization of Goal 1 is effective risk management. Effective risk management involves identifying, measuring, monitoring and controlling risks. The agency has identified seven key risk areas: credit; interest rate; liquidity; transaction; compliance; strategic; and reputation. Accordingly, NCUA must be prepared to align resources, processes, and tools with identified risks, as well as enhance planning for future risks. Ensuring effective risk-focused supervision also requires an adequate framework to document decisions about risk. Examiners use the DOR to outline plans and agreements reached with officials to reduce identified areas of unacceptable risk. The DOR identifies persons responsible for managing the risk category and documents timeframes for correction.

There are 8,400 federally insured credit unions with insured shares of \$534 billion. Included in the totals are 5,200 FCUs, with insured shares of \$296 billion. Low to moderate risk credit unions, as identified by CAMEL ratings 1, 2 and 3, represent 99 percent of the insured shares and 97 percent of insured credit unions. Problem case credit unions, as identified by CAMEL ratings 4 and 5, represent one percent of the insured shares and three percent of insured credit unions.

NCUA-Issued DOR Guidance

NCUA has issued guidance to staff for use in addressing risks and preparing plans for action. This guidance is found primarily in the following chapters of the NCUA Examiners Guide: Chapter 1 (Risk Focused Program); Chapter 2 (Scope Development and Planning); Chapter 3 (Total Analysis Process); Chapter 20 (Report Writing); Chapter 21 (Joint Conference and Exit Meeting); Chapter 22 (Examination Evaluation and Review Policy); and Chapter 30 (Administrative Actions). Additional guidance is available in respective NCUA regional supervision and examination manuals.

PURPOSE AND OBJECTIVES

As stated above, NCUA Strategic Goal 1 is a safe, sound and healthy credit union system. The NCUA Annual Performance Budget 2007 reports that resources are allocated proportional to existing and merging risks based on their potential impact on goal achievement. The agency allocates by far the most resources to Strategic Goal 1. Due to the importance of Strategic Goal 1 and the extent to which agency resources are committed to achieve that goal, the NCUA OIG performed a 2006 review entitled “NCUA’s Risk Focused Examination Process for Federal Credit Unions” (Report #OIG-06-08). As a follow-up to that report, the OIG performed this review to evaluate the following: (1) the process examiners use to track deficiencies identified and documented in the DOR during FCU examinations; (2) the process examiners use to follow-up on the deficiencies identified in the DOR; and (3) whether examiners are ensuring that FCUs follow-up and resolve deficiencies documented in the DOR in a timely manner.

SCOPE AND METHODOLOGY

Our review of “NCUA’s Risk-Focused Examinations Tracking Identified Documents of Resolution (DOR)” looked at DORs produced in 2006 and early 2007.

To meet our survey objectives we:

1. Identified and performed limited review of NCUA DOR guidance;
2. Interviewed certain NCUA E&I staff members; and
3. Identified and selected for review two samples of DOR (25 open DOR and 25 closed or resolved DOR).

This survey was performed in accordance with Generally Accepted Government Auditing Standards.

RESULTS

NCUA DOR Guidance

This survey work was preparatory to performing an audit in this area. We focused on two key areas in the guidance: (1) examiner preparation of DOR to reduce areas of unacceptable risk; and (2) subsequent monitoring and follow-up to ensure FCUs were progressing in their efforts to correct previously identified risk areas. We concluded that examiners are preparing and monitoring DOR in accordance with guidance. Our conclusion is based on examiner-prepared documentation we reviewed during our two DOR sample reviews as well as discussions with NCUA staff.

Process to Track Deficiencies Identified in DOR during Examinations

We concluded that NCUA has a process in place for examiners to track deficiencies identified in DOR. We based our conclusion upon our discussion with NCUA staff, review of NCUA guidance, and review of examiner-prepared documentation related to DOR in our two sample reviews.

Chapter 1 of the Examiners Guide provides guidance to examiners for reviewing areas containing the most risk for an individual credit union. The Guide also emphasizes the need for on-going risk-focused supervision as an integral part of the RFE process, in order to resolve current problems and avoid future ones. The RFE approach requires scope development through a process involving recommendations from the prior examination and supervision contacts. District examiners must provide a credit union the attention it needs to identify and reduce risk and to fully resolve problems. After analyzing the credit union's operation, the examiner makes recommendations for action based on conclusions reached and final risk assessments. The recommendations address what the credit union should do to correct its problems. Examiners use the DOR to outline plans and agreements reached to reduce areas of unacceptable risk. An area of unacceptable risk is one for which credit union management does not have the proper structure for identifying, measuring, monitoring, controlling, and reporting risk. In addition to the DOR, an examiner prepares a contact information report. The effectiveness of the contact information reports depends on the development and communication of proper resolutions for the risk and problems identified during both the scope development and the examination. Subsequently, regional office Division of Supervision analysts review certain contact information reports and determine if the DOR contains reasonable, effective, and timely corrective action plans. In addition, the supervisory examiner for each examiner will evaluate the timeliness and effectiveness of the report solutions.

NCUA implemented an AIRES 2005 system update as a rolling release based on examiner training in the third and fourth quarters of 2005 to be effective during 2006 examination and supervision contacts. The update included a national DOR tracking module including the on-line Exam Management Console (Console). The Console makes readily available to users various information including DOR for specific credit unions. Currently, system users such as regional offices can generate self-designed tracking reports for issues such as unresolved problem

codes/DOR for various risk areas and risk factors using Access Queries. Moreover, the agency updated AIREs 2005 in December 2006, adding a new navigation pull down menu to allow for viewing of historical information in the Exam Management Console, Scope, DOR, and Compliance Violations categories. In addition, NCUA is in the process of developing and testing several DOR monitoring reports that will be available for use at all levels of the agency. It is anticipated the additional reports will be implemented the latter part of 2007. The reports were not reviewed during this work.

Follow-up on Deficiencies Identified in DOR

We concluded that NCUA has a process in place to follow-up on deficiencies identified in DOR. We based this conclusion upon our review of examiner-prepared documentation for supervision contacts for a sample of 25 open DOR at FCUs. We selected our judgmental sample from information provided by E&I on January 31, 2007, that showed a total of 3,884 FCUs in all five NCUA regions--with one or more open DOR.

The purpose of the sample review was to determine from a broad cross-section of FCUs the number of DOR still outstanding; if progress being made to resolve the DOR was on track; and the number of DOR deemed not on track for timely completion. We found that all 25 credit unions were on track to resolve the DOR identified deficiency in a timely manner. However, we found in discussion with staff and during our sample review that DOR were most often updated when examination contacts and supervision contacts exceeded 24 hours of charged review time. On-site contacts taking more than 8 hours and less than 24 hours could result in not all DOR being reviewed and updated unless the contact was for that specific risk area. Finally, we found that short time supervision contacts were usually reserved to address specific problems.

Examination documentation we reviewed for the sample included the Examination Management Console online, the old/new DOR, Problem Report, and Confidential Section or Executive Summary section of the contact report. Our sample represented five credit unions for each of the five NCUA regions. The average size of total shares for the sampled credit unions was \$27 million, with the largest credit union having \$205 million in shares and the smallest credit union having \$400 thousand in shares. The sample credit union composite CAMEL codes included: 2 Code 1 FCUs; 10 Code 2 FCUs; 6 Code 3 FCUs; 6 Code 4 FCUs; and 1 Code 5 FCU. The sample credit unions had as few as 1 DOR, and as many as 67 DOR, with the average number being 13. The most frequently identified risk in our sample was credit risk representing 60 percent of the 25 DOR sample. The second most identified risk in our sample was transaction risk representing 20 percent of the sample.

Follow-up and Resolution of DOR Completed in a Timely Manner.

We concluded that NCUA does have a process to ensure that follow-up and resolution of deficiencies documented in the DOR are completed in a timely manner. This conclusion is based upon our review of examiner-prepared documentation of contacts for a sample 25 closed DOR during the fourth quarter 2006 (contacts with start dates from October 1, 2006 through December 31, 2006). We selected our judgmental sample from information E & I provided to us

on February 16, 2007. The information indicated a total of 1,028 FCUs in all five NCUA regions with at least one closed DOR for the period selected.

The purpose of the sample review was to determine the DOR anticipated resolution date; to determine if the credit union met the DOR resolution date; and to determine the number of months between problem identification and closure of the DOR. Examination documentation we reviewed included, when available, the Examination Console on-line, Old and New DOR, Problem Report, and Confidential Section/Executive Summary Section of the examination or supervision contact report. We found that all 25 sample DOR had documented anticipated resolution dates. Twenty three of the 25 DOR were resolved by the anticipated resolution dates. Moreover, we found that at the time of our review one DOR was classified as no longer applicable, and one DOR was ultimately closed, although not within the anticipated resolution date. We calculated the number of months between the problem identification date and the indicated DOR resolution date. The average time in months for sample DOR resolution was 10 months, with four of the five regions averaging four to seven months and one region averaging 27 months. In a few instances there appeared to be a conflict between the Examination Console on-line information and available supervision contact work papers (particularly off-site Code 27, and low hour Code 22) uploaded to the AIRES system, with on-line indicating DOR resolution. However available AIRES uploaded documentation did not support that information. We were informed by E&I staff that in some instances supervision contacts require limited documentation. In the instances of examinations and higher hour supervision contacts (supervision contacts in excess of 24 hours) adequate documentation was available and we could determine the timely and adequate closure of DOR for our sample.

APPENDIX A – MANAGEMENT COMMENTS




National Credit Union Administration

EI/AVH:ah
SSIC 5000

VIA E-Mail

TO: William DeSarno, Inspector General
Office of Inspector General

FROM: J. Leonard Skiles, Executive Director 

SUBJ: Comments on Draft OIG Survey Report NCUA's Risk-Focused Examinations Tracking Identified Documents of Resolution

DATE: July 9, 2007

This memorandum responds to your request for comments on the draft OIG survey report titled *NCUA's Risk-Focused Examinations Tracking Identified Documents of Resolution* (Report #OIG-07-06). I am pleased to read that your survey report found examiners are preparing and monitoring DORs in accordance with agency guidance.

For clarity, I recommend editing the fourth paragraph of the Executive Summary to read:

The NCUA Office of Examination and Insurance (E&I) informed us that the agency had developed and implemented a national tool for monitoring contact and DOR information called the AIREX Exam Management Console - Online. Additionally, E&I is in the process of developing, testing, and implementing five online DOR monitoring reports that will work outside of the AIREX system.

Also for clarity, change the last sentence of the Executive Summary to refer to "online monitoring tools" instead of "online management console."

Thank you for the opportunity to review the draft report.

cc: Director David M. Marquis
Office of Examination and Insurance

Assistant Inspector General for Audit Jim Hagen
Office of Inspector General

s:\staffolders\AVH\IG Reports\IGMemo-ResponseToDORSurveyRpt.doc