NATIONAL CREDIT UNION ADMINISTRATION
OFFICE OF INSPECTOR GENERAL

AUDIT SURVEY OF
SHARE INSURANCE FUND LOSSES

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EXECUTIVE SUMMARY

The National Credit Union Share Insurance Fund (NCUSIF) reports insurance losses due to failed federally insured credit unions. Several National Credit Union Administration (NCUA) offices are involved in recording and reporting of such losses. The NCUA Office of Inspector General (OIG) performed an audit survey to assess the accuracy and reliability of reported insurance losses for credit unions that failed in 2004.

We determined that the number of failed credit unions and their related insurance losses for the year ended December 31, 2004, were reported inconsistently among several offices. As a result, the number of failures reported in 2004 varied from 18 to 21 federally insured credit unions. The reported insurance losses for those failures ranged from $12.9 to $14.1 million. This was caused primarily by not having a clear and consistent cut-off date for recording and reporting insurance losses. We obtained insurance loss information for the year ended December 31, 2004, from the Office of the Chief Financial Officer (OCFO), the Office of Examination and Insurance (E&I), the NCUA Asset Management and Assistance Center (AMAC), and from all five NCUA Regional Offices.

We assessed inherent risks, reviewed insurance loss recording and reporting procedures, and compared credit union failures and insurance losses among various reports. We also conducted an analysis of the data provided and conducted interviews with management to address the discrepancies we identified.

Regional and AMAC insurance loss data for failed credit unions is communicated to OCFO and E&I by different means and for different purposes. The source information for insurance losses is continually updated for any given reporting period with no consistently defined period cut-off posting date. Consequently, the information reported is dependent upon its run date. Moreover, no reconciliation is performed between source data and reported data for accuracy and consistency.

We offered two recommendations to clarify and improve reporting of losses to the Share Insurance Fund.

BACKGROUND

The NCUSIF was established as a revolving fund in the United States Treasury under the management of the NCUA Board for the purpose of insuring member share deposits in all federally chartered credit unions and in qualifying state chartered credit unions that request insurance. The maximum amount of insurance is $100,000 per shareholder account.

Each year, if federally insured credit unions fail, either through liquidation or an assisted merger, the NCUSIF may incur a loss. The OCFO Division of Insurance reported in the NCUA's 2004 Annual Report that 21 credit unions failed during 2004 resulting in $12.9 million in losses for the year.

Each month, the NCUSIF issues financial statements for management's use, including supporting tables with insurance loss activity. Each calendar year end, the NCUSIF issues audited financial statements where insurance losses are reported.

During 2004, the NCUSIF adopted a new methodology for recognizing insurance losses by establishing a contingent liability (reserve for losses) based upon estimated annual losses from failed credit unions. E&I prepares the reserve for loss calculations based upon information supplied by AMAC and the five NCUA regional offices. The methodology is a five step process:

<u>Step 1</u> – Insured credit unions are grouped into nine risk pools.

<u>Step 2</u> – Failure rates for risk pools are determined by calculating the number of failed credit unions in the past two years divided by the total number of credit unions for each risk pool. Total assets times the calculated failure rate for each risk pool are totaled to arrive at total assets subject to failure.

<u>Step 3</u> – A ten year average loss experience rate is calculated. The ten year average loss experience rate times the assets subject to failure determines the non-specific case reserve needs.

<u>Step 4</u> – Non-specific case reserve needs are added to specific case (credit unions with 100% probability of failure) reserve needs to give total reserve needs.

<u>Step 5</u> – Reserve needs are calculated with a 90% confidence interval upper limit. The NCUSIF Investment Committee can set the reserve for losses anywhere from the calculated reserve needs to the 90% upper limit confidence interval.

Regions initially report pending liquidations and requests for NCUSIF assistance in assisted mergers. This information is relayed to the NCUSIF via telephone. Once a liquidation occurs, the NCUA AMAC assumes responsibility for the case. AMAC determines case reserve needs and forwards this to E&I for reserve calculation purposes. A liquidation loss report is provided to OCFO and E&I reflecting loss activity. Monthly loss activity journal entries are "parked" by AMAC and posted after NCUSIF review. Regional staff sends reserve needs requests for assisted mergers to E&I. E&I uses this to prepare their reserve needs worksheet which is provided to NCUSIF. Approved assistance is processed, paid and recorded by the NCUSIF.

PURPOSE AND OBJECTIVES

In June 2005, the OIG completed a review of Federally Insured State Chartered Credit Unions. As part of that review, we attempted to determine the amount of realized losses for failed federally chartered credit unions versus the amount of realized losses for failed state charted credit unions over the past ten years. We were unable to verify the losses reported with our limited analysis.

For this reason, we decided to conduct an audit survey to determine the accuracy and reliability of reported insurance losses. The objective of this audit survey was to assess the accuracy and reliability of reported insurance losses for credit unions that failed in 2004.

SCOPE AND METHODOLOGY

To accomplish our objective, we assessed the inherent risks of recording and reporting insurance fund losses. This assessment was based upon a review of the importance of the subject matter; complexity of operations; sensitivity of the data; and the flow and liquidity of funds. In addition, we reviewed previous audits and reviews related to the subject, and assessed the degree of any changes to the program.

We focused our review on those credit unions that failed during 2004. We obtained from NCUSIF staff a detailed listing of the names and amount of losses per credit union for the 21 failed credit unions reported by the NCUSIF in the 2004 NCUA Annual Report. We attempted to verify the number of credit unions that failed and the reported losses for those credit unions by comparing this listing to the following:

1. 2004 failed credit union losses reported in the NCUSIF financial statements;
2. 2004 failed credit union losses reported by E&I in their 12/31/04 reserve for loss calculation;
3. related credit union losses reported by AMAC via their individual failed credit union financial statements; and
4. 2004 reported losses by each region and through the regionally maintained GENISIS[1] system.

We reviewed the reserve for loss methodology and reviewed insurance loss recording and reporting procedures. We also conducted an analysis of the data provided and conducted interviews with management to address the discrepancies we identified. This audit survey was conducted in accordance with Generally Accepted Governmental Auditing Standards, except for our scope limitation discussed above.

[1] GENISIS is the national system used to track and report the history of insurance related items including mergers and liquidations

RESULTS

The number of reported credit union failures and related amounts of insurance losses differed among the various NCUA reporting offices for the year ended December 31, 2004. As a result, the reported credit union failures ranged from a high of 21 to a low of 18 in 2004. The reported insurance fund losses for failed credit unions during 2004 ranged from $12,895,344 to $14,114,744. This was caused by not having a clear and consistent cutoff date for recording and reporting insurance losses. In addition, reconciliations were not performed on recorded and reported information among offices. This resulted in questionable reliability of the reported number of credit union failures and the amount of related insurance fund losses. (See Appendix A)

The following is a breakdown of how NCUA reported 2004 failed credit union insurance losses. These insurance losses were reported in the NCUA Annual Report, NCUSIF year end financial statements, E&I's year end reserve for insurance loss calculations, and AMAC and regional reports. Listed below are eleven examples of differences between the various reports.

<u>2004 NCUA Annual Report</u>

The 2004 NCUA Annual Report section, "National Credit Union Share Insurance Fund", stated that "twenty-one credit unions failed during 2004, resulting in $12.9 million charged to reserves." Listed below are two examples of differences reported in the annual report compared to other reports.

Credit Union	NCUA's Annual Report	Financial Statements	E&I - Reserve for Losses	AMAC and Regions
BrooklynEcu	$873,761	$255,077	$904,931	$255,077
Midwood	0	1,004,911	1,004,911	1,004,911

The detail support for the annual report listed Brooklyn Ecumenical Credit Union as having a $873,761 loss for 2004. The NCUSIF financial statements and AMAC, on the other hand, reported a $255,077 insurance loss for this institution. The difference of $618,683 supposedly represented the loss for a purchase and assumption. OCFO acknowledged the annual report was overstated by this amount after it was brought to their attention by the OIG. Further, the region reported that the credit union received $459,506 in NCUA assistance. In another case, Midwood Credit Union showed $0 for losses in the 2004 annual report. However, the year end financial statements and the 12/31/04 AMAC Midwood Credit Union financial statement reported a $1,004,911 loss for the year. The OCFO explained this as a timing difference. However, this credit union failed on December 16, 2004.

2004 NCUSIF Financial Statements

The National Credit Union Share Insurance Fund 2004 year end financial statements listed twenty one credit unions which failed in 2004, resulting in $13.2 million charged to reserves. Listed below are two examples of differences reported in the NCUSIF financial statements compared to other reports.

Credit Union	NCUA's Annual Report	Financial Statements	E&I - Reserve for Losses	AMAC and Regions
N. Florida	$0	$1,125	$ N/A	$ N/A
Little Haiti	307,622	253,918	307,622	308,736

North Florida was listed as a failed credit union in 2004 with a $1,125 loss. However, the annual report listed the credit as a failure but with a $0 loss. Nether E&I nor AMAC or the region listed this credit union as a 2004 failure. The OCFO was unable to explain why Little Haiti Credit Union had a reported loss of $253,918 in the 2004 financial statements, yet the annual report and E&I reserve calculation reported a $307,622 loss while AMAC reported a loss of $308,736.

2004 E&I Year End Reserve For Losses

The December 31, 2004 Reserve for Pool Loss calculation listed seventeen failed credit unions in 2004 with losses of $13.1 million. One specific case failure was listed with a loss of $1.0 million, giving a total of eighteen failures with losses of $14.1 million. Listed below are five examples of differences reported in E&I reserve for loss calculation compared to other reports.

Credit Union	NCUA's Annual Report	Financial Statements	E&I - Reserve for Losses	AMAC and Regions
St.Gregory	$1,078,000	$1,078,000	$1,077,013	$1,078,000
Austin W	211,207	211,207	211,300	211,207
Vestal	-1,704	-1,704	N/A	-1,704
Com Milw	-122,814	-122,814	N/A	-122,814
Appalachia	156,516	156,516	216,211	156,516

Two credit unions (Vestal and Community of Milwaukee) were listed by AMAC and the OCFO with insurance gains. Therefore, these two credit unions were not listed as "failures" in the reserve for loss calculation. Three credit unions (St. Gregory, Austin West Garfiled, and Appalachian Development) reported insurance losses in the reserve for loss calculations that did not agree with the respective losses reported in the annual report, year end financial statements or AMAC/Regions.

2004 Year End AMAC and Regional Reporting

AMAC reported thirteen credit unions failing in 2004 with insurance loss activity totaling $11.7 million. The five regional offices listed six additional credit union failures. The loss activity for these nineteen credit unions totaled $13.2 million. The GENISIS system listed seven assisted mergers and 16 liquidations in 2004 for a total of 23 failures. Listed below are two examples of differences reported in AMAC and reports compared to other reports.

Credit Union	NCUA's Annual Report	Financial Statements	E&I - Reserve for Losses	AMAC and Regions
Sorvall	20,000	20,000	20,000	N/A
Butler	911,513	911,513	911,513	908,961

Sorvall Credit Union was not listed as a failure by the region, but was listed as a failure by E&I and OCFO in the annual report and financial statements. US Employees Butler Credit Union had a reported loss by AMAC which differed from that reported by OCFO and E&I.

Insurance Loss Recording and Reporting Procedures

Previous year end financial statement audits have identified several internal control weaknesses, primarily Information Technology (IT), with NCUA's financial accounting system. In general, these weaknesses relate to a lack of documented policies and procedures, a lack of segregation of duties, and a lack of activity and security monitoring. Recording and reporting insurance losses is a high risk program. The activity of recording and reporting insurance losses is moderately complex with several offices involved in the process. The process of liquidating credit unions involves numerous individual transactions resulting in highly liquid transactions. According to OCFO, the insurance loss systems for the OCFO, AMAC and the regions have different posting cut-off dates due to workflow requirements for each office. AMAC's monthly posting cut-off date is a few days before month end, whereas the OCFO monthly posting cut-off date is the last working day of the month. The OCFO retains copies of AMAC journal entries and AMAC/regional requests for funds. In turn, the OCFO sends the NCUSIF monthly report and general ledger entries to AMAC and the regions for review and reconciliation. AMAC also receives a periodic listing of involuntary liquidation and assisted Purchase and Assumption activity retained on an OCFO access data base. If there is a discrepancy, AMAC and/or the regions are to contact OCFO. However, the reporting discrepancies discussed above indicate:

- the insurance loss recording and reporting function lacks adequate verification of reported amounts;
- there is no reconciliation or verification of reported transactions between offices; and
- there is no consistent period ending cut-off date for reported transactions.

RECOMMENDATION 1

OCFO should establish a consistent closing date for reporting failures and realized losses each fiscal year. OCFO should also establish a closing date for posting all source data transactions related to Share Insurance Fund losses.

The OCFO agrees with the recommendation. The OCFO further stated that they will establish a consistent closing date for reporting failures and realized losses each fiscal year; excepting any year end adjustments recommended by the financial statement auditors.

RECOMMENDATION 2

OCFO should reconcile reported losses to the source data from reporting offices.

The OCFO stated they will provide E&I with monthly reserve transactions for their review, as they already provide to AMAC and the regions. OCFO will also provide the number of credit union and related loss amounts for current year failures to E&I, AMAC and the regions for their review. OCFO further stated that they are now reconciling monthly SAP, NCUSIF's Access database and AMAC's loss reports. In addition OCFO states the NCUSIF continues to reconcile SAP and E&I's Reserve Needs Report, but the NCUSIF cannot reconcile SAP with AMAC and Region requests for reserving since E&I doesn't always reserve in either the amount or month the request is submitted to E&I.

E&I stated they prefer to utilize the most recent data in preparing non-specific reserve calculations. Using the most recent data would create a prohibitive volume of subsequent entries to allow reconcilement with the amounts reported in the year end financial statements. E&I further stated that its Division of Risk Management has been working with the OCFO and AMAC to help resolve some of the accounting issues that impact the reporting of net losses for each individual credit union and will continue to provide assistance as workload allows.

APPENDIX A – 2004 CREDIT UNION FAILURES and REPORTED LOSSES

Credit Union	NCUA's Annual Report	Financial Statements	E&I - Reserve for Losses	AMAC and Regions
1 – Tepeyac	$9,000	$9,000	$9,000	$9,000
2 – Sorvall	20,000	20,000	20,000	
3 – BrooklynLng	41,047	41,047	41,047	41,047
4 – Denver	260,174	260,174	260,174	260,174
5 – HCA	25,000	25,000	25,000	25,000
6 – Henry St	112,656	112,656	112,656	112,656
7 – St.Gregory	1,078,000	1,078,000	1,077,013	1,078,000
8 – N. Florida	0	1,125		
9 – Austin W	211,207	211,207	211,300	211,207
10 – Vestal	-1,704	-1,704		-1,704
11 – BrooklynEcu	873,761	255,077	904,931	255,077
12 – Oak Cliff	1,120,876	1,120,876	1,120,876	1,120,876
13 – Dallas Ed	4,456,159	4,456,159	4,456,159	4,456,159
14 – Union Pac	1,410,999	1,410,999	1,410,999	1,410,999
15 – Com Milw	-122,814	-122,814		-122,814
16 –Appalachia	156,516	156,516	216,211	156,516
17 – Little Haiti	307,622	253,918	307,622	308,736
18 – Diakonia	265,114	265,114	265,114	265,114
19 – NorCar	1,760,218	1,760,218	1,760,218	1,760,218
20 – Butler	911,513	911,513	911,513	908,961
21- Midwood	0	1,004,911	1,004,911	*1,004,911
TOTALS	**$12,895,344**	**$13,228,992**	**$14,114,744**	**$13,260,133**

* Specific Case