



NCUA
National Credit Union Administration

**OFFICE OF INSPECTOR
GENERAL**

AUDIT OF THE NCUA'S EXAMINATION HOURS

**Report #OIG-24-07
June 18, 2024**



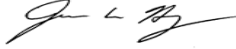


National Credit Union Administration

Office of Inspector General

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FROM: Inspector General James W. Hagen 

SUBJ: Audit of the NCUA's Examination Hours

DATE: June 18, 2024

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) conducted this self-initiated audit to assess the NCUA's examination hours. The objectives of our audit were to determine: (1) the NCUA's effectiveness in establishing examination hours, and (2) whether the NCUA ensured proper regulatory safeguards remained in place to protect the credit union system, credit union members, and the National Credit Union Share Insurance Fund (SIF) while appropriately managing the examination burden on credit unions.

Results of our audit determined that the NCUA was effective in establishing examination hours. We also determined the NCUA had safeguards in place to protect the credit union system, credit union members, and the SIF while appropriately managing the examination burden on credit unions. Therefore, we are making no recommendations in our report to management.

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.

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EXECUTIVE SUMMARY

The NCUA OIG conducted this self-initiated audit to assess the NCUA's examination hours. The objectives of our audit were to determine: (1) the NCUA's effectiveness in establishing examination hours, and (2) whether the NCUA ensured proper regulatory safeguards remained in place to protect the credit union system, credit union members, and the National Credit Union Share Insurance Fund (SIF) while appropriately managing the examination burden on credit unions. The scope of our audit covered the NCUA's budgeting of examination hours for 2023 and 2024 and the NCUA's programs/initiatives from 2012 to June 2022 that have impacted the examination burden on credit unions.

Our audit determined the NCUA was effective in establishing examination hours. We also determined the NCUA had safeguards in place to protect the credit union system, credit union members, and the SIF while appropriately managing the examination burden on credit unions. Therefore, we are making no recommendations in our report to management.

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 that insures deposits of federally insured credit unions, protects members who own credit unions, and charters and regulates federal credit unions. The NCUA's organizational structure consists of a Headquarters, Asset Management and Assistance Center, the Office of National Examination and Supervision (ONES), and three regional offices.¹ The Office of Examination and Insurance (E&I) is responsible for NCUA's supervision programs that ensure the safety and soundness of federally insured credit unions. It oversees NCUA's examination and supervision program, including resource management and allocation, and oversees the development and maintenance of examination and supervision policy manuals.

The NCUA's 2022-2026 Strategic Plan's Goal #1 is to ensure a safe, sound, and viable system of cooperative credit that protects consumers. The related strategic objective 1.2 – provide effective and efficient supervision, states:

To remain effective, the NCUA's examination and supervision program must continue to evolve with a growing and changing credit union system while recognizing the fundamental differences that define financial cooperatives. The NCUA must act efficiently, properly allocating examination resources to credit unions of highest risk and expanding its offsite monitoring and examination capabilities. Important components of an effective and efficient examination and supervision program include highly skilled examiners, risk- and compliance-based examination policies, robust quarterly data collection and analyses, reliable technological tools, and a strong quality assurance program.

The Strategic Plan lists strategies to achieve Goal #1, including:

- Continue implementing a risk-based, flexible examination cycle to address supervision priorities without compromising the safety and soundness and regulatory compliance of credit unions.
- Advance data analytics and remote monitoring capabilities to allow field staff to complete high-quality examination procedures offsite and reduce the NCUA's presence in lower-risk credit unions.

The NCUA's National Supervision Policy Manual (NSPM) has a section titled District Management - Examination and Supervision Budgeting that states, "Budgeting is critical to effectively manage resources. Appropriate budgeting ensures resource allocation can be directed to the credit unions of regional and national significance."

¹ The three regional offices (Regions) are the Eastern, Southern, and Western regions.



NCUA's Process for Budgeting Examination Hours

The NSPM requires E&I to annually issue workload budgeting instructions and guidance for the subsequent year. The Regions and ONES then must provide this guidance to examination staff. E&I's Policy Division is responsible for the resource budget and the annual memo. Policy Division staff hold an annual resource budget kickoff meeting prior to sending out the resource budget memo. The kickoff meeting includes the Regions' Associate Regional Directors of Programs (ARDPs), ONES, Office of Consumer Financial Protection, and other NCUA offices, as needed. Attendees discuss and provide feedback to E&I on the budget resource guidance in the memo.

In April 2023, E&I's Director issued the 2024 resource budget memo which provided guidance on the resource budget process to the Regions and ONES. It included budget considerations for 2024, a description of the process, processing dates for each step, budget instructions for each work classification code (WCC),² and links to tools to assist in the budgeting process. The memo stated the NCUA will continue to use a bottom-up approach to budgeting examination and supervision hours for 2024. The memo provided the authorized number of full-time equivalent (FTE) field staff based on the revised 2023 resource budget and required the Regions and ONES to base resource budgets on authorized FTEs. The memo also indicated examiners should use judgment to budget appropriate hours based on a credit union's risk and complexity.

Once the Regions and ONES receive the memo, they either annotate it or generate their own memo with specific guidance for their field staff. The NSPM states the budgeting process begins with examiners. Examiners are to follow the instructions provided by the region for the annual budget process. Examiners are to submit recommended estimated hours to their supervisory examiner (SE) during the process using the Credit Union Resource Allocation module in NCUA's Management Automated Resource System (MARS). Southern Region officials confirmed to us that examiners enter the estimated examination and supervision hours into MARS. The examiners also follow E&I's guidance for inputting hours for Small Credit Union Examination Program (SCUEP) examinations, as necessary.³ For risk-focused examinations, examiners review, among other things, risk reports, CAMELS⁴ ratings, historical trends, results of previous examinations, and current economic factors to estimate the examination hours for each credit union.

Once examiners enter hours into MARS, SEs review the hours for reasonableness and either approve or request changes. If the SE enters the same number of hours into MARS as the examiner did, this action signifies approval of the examiner's recommended hours. SEs can also

² The NCUA categorizes and standardizes work-related activities performed by NCUA field examiners and office staff through the use of WCCs.

³ Depending on the credit union's asset size, examiners are to budget an average of either 53, 80, or 102 hours region-wide for SCUEP defined scope examinations. SEs and ARDPs are responsible for reviewing the hours budgeted and adjusting them as appropriate to ensure the average budgeted examination hours do not exceed the specified average hours for the region.

⁴ Examiners assign a numeric value to each of the CAMELS components based on the evaluation of six critical elements of a credit union's operations over the course of an examination. The six elements are Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk.



revise these hours if necessary. A Western Region ARDP told us he will review (1) the reasonableness of the submitted hours, (2) whether examiners and SEs followed E&I guidance, and (3) the range of hours within the various credit union asset size groups to check for outliers. After the ARDPs conclude their review, the Southern Region Regional Director (RD) told us he will perform a review of the submission to determine if everyone followed E&I guidance. He will also check the proposed budget for reasonableness, accuracy, and consistency from year to year.

Once the Regions and ONES complete their budget resource requests, they send them to E&I's Policy Division. Policy Division staff then check each submission to ensure: (1) the Regions and ONES followed the guidance in the memo, (2) the numbers are accurate, and (3) they understand how the Regions and ONES arrived at their hours. Policy Division staff then compare the proposed budget to the previous year's budget looking for year-to-year changes that may have occurred. They will then compile all the data into a presentation for senior NCUA management and the Board.

The NCUA posts its draft budget on the agency's website for review and comment and submits it for publication in the Federal Register. The NCUA released its 2024-2025 proposed budget on October 26, 2023, with the comment period remaining open until November 21, 2023. On November 16, 2023, the NCUA held a public briefing on the proposed budget. The NCUA Board met December 14, 2023, and approved, among other things, the agency's 2024 and 2025 budgets. Once the Board approves the budget, E&I Policy Division staff take the Board approved budget and develop a resource budget revision memo, which includes any adjustments needed to be made to the Regions or ONES resource budgets. E&I's Director then sends this memo to the Regions and ONES to make the needed adjustments.

On January 23, 2024, E&I's Director issued the resource budget revision memo to the Regions and ONES directing them to revise the 2024 resource budget. The memo instructed the Regions to revise examination hours, which included extending scheduled examinations by 2 months for credit unions that qualify for the extended cycle, increasing hours for the Consumer Financial Protection examination program, removing examination hours for credit unions in the process of merging, adding hours for the Regional Large Credit Union Program, adjusting examination hours due to CAMELS rating changes, and deferring examination hours for discretionary federally insured, state-chartered credit union examinations scheduled – but not required. We determined that each Region acted on the memo and informed E&I of the changes made to their resource budgets including requested revisions to examination hours.

NCUA's Programs/Initiatives Impacting Examination Burden on Credit Unions

SCUEP - NCUA implemented the SCUEP in 2012. SCUEP streamlined the examination process of small federal credit unions with a CAMELS rating of 3 or better. The NCUA made this change to allocate resources appropriate to the risk posed by each credit union to the SIF. The Letter to Federal Credit Unions announcing the SCUEP noted that Regional Offices do have discretion to either expand the scope of an examination or exclude an eligible federal credit union based on its level of risk. In the NCUA's Supervisory Priorities for 2015 letter to credit



unions, the NCUA announced an update to the SCUEP. In 2015, NCUA's SCUEP employed a defined-scope examination approach that focused staff attention on the primary areas of risk for small credit unions: internal controls, recordkeeping, and lending. This narrower, defined scope required field staff to focus on risk exposures in the areas that historically have led to small credit union failures and losses to the SIF. These defined scope examinations under the SCUEP were allowed for credit unions with \$50 million in assets or less and CAMELS ratings of 1, 2, or 3.

Exam Flexibility Initiative (EFI) - In 2016, the NCUA established an EFI internal working group. The working group's objectives included:

- Determining the future examination cycle for federally insured credit unions,
- Improving coordination with state supervisors in the examination of federally insured, state-chartered credit unions,
- Seeking information from stakeholders, summarizing their input and discussion, and considering their views,
- Taking advantage of new technology to make examinations more efficient and to reduce onsite presence, and
- Identifying program areas where the added flexibility and hours from an extended examination cycle should be repurposed to mitigate risk from an extended cycle and ensure the agency's supervision program remains effective.

When the working group's analysis was completed, it developed 10 recommendations for the NCUA Board's consideration. Some of the recommendations related to managing of examination burden on credit unions included:

- Transitioning well-managed, low-risk federal credit unions that met certain criteria to an extended examination cycle. Examination of qualifying credit unions would generally begin between 14 and 20 months from the prior examination completion date.
- Examinations for federal credit unions not qualifying for an extended examination cycle would generally begin between 8 and 12 months from the prior examination completion date.
- Continuing to conduct examinations using SCUEP for financially and operationally sound federal credit unions with less than \$30 million in assets and continue giving NCUA field staff the discretion to perform these procedures for a credit union with \$30 million to \$50 million in total assets that received a composite CAMELS code 1, 2, or 3 at its last examination.



- Except for federally insured, state-chartered credit unions that met certain criteria, NCUA examinations of these credit unions would not occur less frequently than once every 5 years.
- Establishment of a joint NCUA-State Supervisor Working Group to, among other things, improve coordination and scheduling of joint examinations and reduce redundancy.
- Enhanced planning and notice procedures including providing credit unions more advance notice of examinations and improving coordination of document requests.
- Reducing NCUA's on-site presence.

At the November 17, 2016, NCUA Board meeting, the Board approved operating budgets for 2017 and 2018 to fund NCUA's essential activities and strategic priorities. The Board-approved budgets adopted the ten recommendations contained in the EFI report.

Flexible examination program - One of the recommendations from the EFI internal working group was to expand use of offsite examination procedures to reduce the agency's onsite presence at credit unions. The NCUA piloted a flexible examination program during the second half of 2016. During the program, examiners were encouraged to use agency-approved secure technology to send and receive credit union information electronically to perform as many procedures as possible offsite. One of the benefits observed during the pilot was the reduction of NCUA's onsite presence at credit unions and less interruptions to the daily operations of credit unions. Because of the program's success, the NCUA extended the pilot into 2017. The RD who oversaw the pilot told us they determined approximately 9 percent of examination work was being done offsite but 40-50 percent of examination work could be done offsite.

Risk-Based Examination Scheduling Policy - The NCUA's Risk-Based Examination Scheduling Policy, effective January 1, 2017, also addressed examination burdens on credit unions. It implemented the following improvements to examination procedures: (1) providing credit unions with at least 4 weeks advance notice when scheduling the examination, (2) improving coordination of document requests, and (3) separating and emphasizing pre-examination planning and scoping from the beginning of onsite examination work. The policy noted these improvements addressed concerns documented by the EFI internal working group to help reduce the burden on credit unions and produce more effective and efficient examinations.

Virtual Examination Program - In 2017, the NCUA Board approved the Virtual Examination Program project to research methods to conduct as many aspects of the examination and supervision processes as possible offsite. Key activities of the project to date include: developed and implemented initial offsite procedures and guidance based on the Flexible Examination Pilot results, many of which were utilized and further tested during the agency's COVID-19 offsite posture, and catalogued examination scope steps, which included a breakdown of the purpose of each examination step, explanation of how examiners complete the scope step and requirements for completing that step, determination on whether the examination step could be performed offsite, and additional comments either highlighting non-standard details of each examination



step or noting aspects of examination steps that need further review. An official with the NCUA's Virtual Examination Program project told us that in 2020, the NCUA put out a Request for Information in the Federal Register to solicit feedback and recommendations to guide the NCUA's development of the project. The Request for Information indicated one intent of the NCUA's objective to modernize the agency's examination program was to reduce the burden on credit unions and increase agency efficiency by reducing onsite examination time.

Alternating Examination Program - Created as part of the NCUA's EFI, the NCUA-State Supervisor Working Group's goal was to minimize the burden on state-chartered credit unions that results from having a separate financial regulator and insurer. In 2019, the NCUA and State Supervisory Authorities (SSA)⁵ initiated the Alternating Examination Pilot Program to determine how alternating examinations could improve coordination and optimize federal and state resources while maintaining safe and sound credit union operations. The NCUA and six state regulators piloted an alternating examination program for federally insured, state-chartered credit unions. The program ran from January 1, 2019, to June 30, 2022, covering two examination cycles. For these examinations, the NCUA and the SSA alternated which agency was the lead on the examination. The NCUA issued a lessons learned report in August 2023. Along with some specific recommendations, the report made the overall recommendation of the permanent implementation of an alternating examination program. E&I officials shared the recommendations with the NCUA Chairman's Office in February 2024.

Offsite Examination Procedures - On March 1, 2019, the NCUA issued an update to the NCUA's Examiner's Guide to provide guidance to field staff on conducting examinations offsite. The email announcing the update noted that subject to supervisor approval, field staff could request to perform suitable examination work at worksites other than the credit union. Per the Examiner's Guide - Examination & Supervision Contacts – Risk-Focused Exams - Offsite Examination Procedures section, examiners can perform a variety of examination procedures efficiently and effectively without being physically onsite at the credit union. The Guide includes:

- What considerations the examiner should review to determine the amount of examination or supervision contact work that can be conducted offsite for each credit union.
- What examiners should do to ensure the necessary coordination with the credit union goes smoothly.
- A list of examination procedures that had been successfully performed offsite, including pre-examination planning and scoping, writing the examination report, and reviewing materials and reports. The Guide notes that examiners and credit unions may identify other aspects of the examination that lend themselves to being reviewed offsite. Examiners, with supervisor concurrence, must use their judgment in determining the work they can conduct offsite.

⁵ A State Supervisory Authority is the governmental agency of the state in which the credit union is chartered that regulates state-chartered credit unions.



RESULTS IN DETAIL

The objectives of our audit were to determine: (1) the NCUA's effectiveness in establishing examination hours, and (2) whether the NCUA ensured proper regulatory safeguards remained in place to protect the credit union system, credit union members, and the SIF while appropriately managing the examination burden on credit unions. Based on our audit work, we determined the NCUA was effective in establishing examination hours. We also determined the NCUA had safeguards in place to protect the credit union system, credit union members, and the SIF while appropriately managing the examination burden on credit unions.

The detailed results of our audit follow.

Establishment of Examination Hours is Effective

We determined that, overall, the NCUA was effective in establishing examination hours. Specifically, we determined the NCUA established policies and procedures in the NSPM for budgeting examination hours that included the responsibilities of NCUA personnel involved in the budgeting process. We concluded E&I's Policy Division developed and communicated guidance on resource budgeting to examination staff in compliance with the NSPM requirements, as noted in the Background section of this report. We also determined examiners and SEs appropriately established examination hours for the credit unions we sampled, and the agency had mechanisms in place to address challenges identified by examiners, SEs, and senior management with the budgeting of examination hours. The Government Accountability Office's (GAO's) Standards for Internal Control in the Federal Government (Green Book) sets internal control standards for federal entities.⁶ Our audit determined the NCUA adheres to GAO's Green Book, in particular, Principle #3 – Establish Structure, Responsibility and Authority. This principle requires management to establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives. As a result, after reviewing the process in its entirety, we determined the number of budgeted examination hours examiners and SEs developed during the resource budgeting process nearly matched the actual number of examination hours expended; therefore, we determined the NCUA was effective in establishing examination hours.

Details

The activities we performed and the results that support this conclusion are detailed below.

Compared Actual Examination Hours to Budgeted Examination Hours

Based on our review of credit union examinations completed from February 1, 2023, to December 31, 2023, we determined there was only a 2.2 percent difference between what examiners budgeted and the actual number of examination hours expended. See Table 1 below. We believe a difference of this small size is reasonable and indicates the NCUA's effectiveness in establishing examination hours. NCUA officials told us the budgeted hours are a guide and

⁶ GAO-14-704G



examination hours are reviewed and adjusted as needed throughout the year. Adjustments to examination hours may be made due to CAMELS ratings going up or down, supervision plans changing, increasing risk at a credit union, or FTEs changing.

Table 1

Credit union population	# of Exams	Actual Exam Hours	Budgeted Exam Hours	Difference between Actual and Budgeted Hours	Percent Difference
Under \$10 million	425	25,999	23,073	-2,926	11.3
\$10-under 30 million	371	31,126	29,153	-1,973	6.3
\$30-under 50 million	205	20,634	20,294	-340	1.6
\$50-under 150 million	357	58,420	57,957	-463	0.8
\$150-under 500 million	236	65,379	64,241	-1,138	1.7
\$500 + million	398	184,593	200,057	+15,464	8.4
Total	1,992	386,151	394,775	+8,624	2.2

We note that part of the reason budgeted examination hours exceeded actual examination hours in the “Total” and “\$500+ million” populations is due to one region assigning what are known as bulk hours to be allocated to credit unions being examined over the course of the year to one credit union during the budgeting process. E&I’s Revised 2023 Resource Budget Program memo, issued May 12, 2022, directed the regions to budget an additional pool of hours consisting of five percent of total hours budgeted for several WCCs including WCC 10 (federal credit union examinations). The Board granted these additional hours for contingencies, allocated per regional discretion, to account for any additional time necessary for examiners to perform examination-related duties. Based on this direction, one region budgeted all five percent (4,562) of total budgeted hours for WCC 10 to one credit union, making the total budgeted examination hours for the year for that credit union, 5,015.⁷ This resulted in budgeted examination hours in MARS exceeding actual examination hours for this credit union by 4,564 hours (5,015 budgeted - 451 actual examination hours). For efficiency purposes, a Regional official told us that there are times it makes sense to allocate bulk hours to one credit union instead of taking the time-consuming effort to distribute them to each credit union during the budgeting process. These bulk hours are then allocated throughout the year to credit unions being examined.

⁷ The other two regions also budgeted these bulk hours to one credit union in their respective regions. However, they budgeted these bulk hours to credit unions that did not undergo examinations in 2023 due to extended examination cycles. Those hours did not impact the results above as we compared actual examination hours to budgeted examination hours for examinations done in 2023.



Sampled and Reviewed Budgeting Data

We determined the NCUA had appropriately established examination hours for all 34 of the credit unions we selected for testing for 2023 and for all but one (33 of 34) we selected for 2024. Results of our testing determined the regions budgeted examination hours in MARS or, because the credit union was eligible for the extended examination cycle, no examination hours were appropriately budgeted in MARS. For the one credit union in 2024 where we found the region had not appropriately budgeted examination hours for 2024, this occurred because it was believed the credit union had met the extended examination cycle criteria. However, because the last examination for this credit union had occurred in 2019 and federally insured, state-chartered credit unions eligible for the extended examination cycle must be examined at least once every 5 years, examination hours should have been budgeted for 2024 for this credit union. We contacted the associated Region's ARDP, who explained this was due to an oversight and agreed that examination hours should have been budgeted for 2024 for this credit union. We later verified that the SE corrected the oversight by updating the Credit Union Resource Allocation module in MARS by budgeting 70 examination hours for this credit union in 2024.

Interviewed NCUA Personnel

As part of our review of the effectiveness of establishing examination hours, we interviewed senior officials in E&I, ONES, and the Regions, and examiners and SEs in the Regions to determine if there are challenges associated with the process of budgeting for examination hours, and if so, do they have an impact on the effectiveness of the process. Below are the challenges that NCUA management and staff mentioned most often.

- Senior officials in E&I, ONES, and the Regions all described MARS as a challenge. Comments included how MARS is an old system,⁸ based on a calendar year, while the examination program, with an extended examination cycle, is not on a calendar year basis. These same officials also told us using MARS is labor intensive. An E&I official told us that E&I formed a MARS working group in response to feedback received from the Regions on some issues when using MARS. The working group has been discussing the identified issues and what can be done to address them.
- Senior officials from two of the Regions and approximately one-third (10 of 31) of the examiners and SEs mentioned that budgeting examination hours for next year in May and June of the current year was a challenge. Specifically, they told us how much could change in terms of the credit unions' risk profile and the examination procedures between when they budget examination hours for credit unions and when the examinations start the next year. They also told us how the examination scope instruction, which could impact required examination steps, and the supervisory priorities letter, which is annually sent out to all credit unions, are not issued by the agency until the following December or January and therefore are not available for their use when working on the examination hours budget process in May and June.

⁸ MARS was originally deployed around 2004.



However, senior officials from E&I, ONES, and the Regions also mentioned how changes to the budget are made throughout the year due to changes in the CAMELS ratings of credit unions based on prior examinations, supervision plans, and FTEs. One senior official referred to the budget as a living, breathing process. In that regard, E&I's 2024 Resource Budget Program memo states the NCUA uses "the normal budgeting process as a baseline and will make programmatic changes to examination requirements and/or staffing levels, as necessary, through the normal budget management and revision process." Also, the NSPM states that examination staff may change their examination and supervision plans at any time if circumstances warrant, after consulting with the assigned field supervisor. We believe the ability to revise examination hours due to changing circumstances addresses the challenge NCUA officials brought to our attention when budgeting examination hours for next year in May and June of the current year.

- We also asked examiners whether they had enough hours to perform examinations and if not, were they reluctant to request additional hours from their field supervisors, and, if so, why. Seventy-four percent (14 of 19) of the examiners we interviewed told us they did not always have enough time to perform examinations.⁹ Fifty percent (7 of 14) of the examiners who responded that way also said this was especially true for smaller credit unions.¹⁰ However, 42 percent (8 of 19) also told us they knew they could ask for additional hours and that their SE would work with them to fulfill their request. Further, 81 percent (13 of 16)¹¹ of the examiners responded that they were not reluctant to ask for additional time to complete an examination, and 46 percent of those examiners who responded in that manner also indicated they had not had issues with their SE approving their requests for additional hours.

Reviewed Relevant Policy and Procedures

As mentioned in the Background section of this report, the NCUA has a process in place for budgeting examination hours. We reviewed the policies and procedures that govern this process, specifically, the NSPM and E&I's resource budgeting memos to the Regions and ONES. We determined both the NSPM and the memos detailed the responsibilities of the NCUA personnel involved in the resource budgeting process. We determined E&I's resource budgeting memos provided guidance on the resource budgeting process to the Regions and ONES. The memos include budget considerations, a description of the process, processing dates for each step in the budgeting process, budget instructions for each WCC, and links to tools to assist in the budgeting process. We determined E&I's resource budgeting revision memos, sent to the Regions and ONES after the NCUA Board approves the budget, provided guidance on adjusting the budgeted

⁹ We note 36 percent (5 of 14) of the examiners who said they did not always have enough time to perform examinations also mentioned how the use of the Modern Examination and Risk Management Identification Tool (MERIT) was contributing to examinations taking longer.

¹⁰ The SCUEP defines small credit unions eligible for defined scope examinations as federal credit unions with \$50 million in assets or less.

¹¹ Three examiners told us they were reluctant to ask for additional hours because it could be viewed negatively. Three other examiners did not provide a Yes or No answer to this question and are not included in the calculated percentage.



resource hours in MARS to align with the Board approved budget. Based on our review of the NSPM and E&I's resource budgeting memos, we believe this guidance on budgeting examination hours is adequate and contributes to the NCUA's effectiveness in establishing examination hours.

Compared Budgeting Examination Hours Process to Guidance

We compared the NCUA's guidance on budgeting examination hours to examination staffs' execution to assess the agency's effectiveness of the process, and we determined staff adequately complied with all relevant guidance. As previously mentioned, the NSPM section titled District Management - Examination and Supervision Budgeting, requires E&I to annually issue workload budgeting instructions and guidance to examination staff for the subsequent year. The NSPM also requires the Regions to provide guidance to examination staff. The budgeting process begins with examiners who must follow the instructions provided by the Regions and ONES for the annual budget process. Examiners are required to submit recommended estimated examination hours to their supervisor during the annual resource planning process using the Credit Resource Allocation module in the online system, MARS. We determined NCUA staff adequately complied as follows:

- E&I issued budgeting instructions and guidance for the subsequent year to the Regions and ONES.
- Based on E&I's guidance, the Regions and ONES provided budgeting guidance to their respective examination staff.
- With one exception, as described above, examiners successfully entered examination hours into the MARS Credit Resource Allocation module if the credit union was due for an examination.

Also, both the 2023 and 2024 Resource Budget Instruction Memos from E&I stated that field supervisors are to review and discuss with staff, where necessary, the recommended examination and supervision hours for credit unions assigned to their group, paying particular attention to instances when an examiner significantly changed the recommended hours from prior years. Our tests of selected credit unions determined, based on data and comments entered by the SEs in MARS, that they reviewed the hours entered by the examiners.

Based on our fieldwork, we determined the NCUA was effective in establishing examination hours. Therefore, we are not making a recommendation to NCUA management.

**Safeguards in Place While
Managing Examination
Burden on Credit Unions**

We determined NCUA management has implemented a number of programs/initiatives and taken actions that have impacted the examination burden on credit unions. We also determined that the NCUA had safeguards in place, through policy and practice, to protect the credit union system, its members, and the SIF. Our audit determined the NCUA adhered to GAO's Green Book, in



particular, Principle #10 – Design Control Activities and Principle #12 – Implement Control Activities. Principle #10 requires management to design control activities to achieve objectives and respond to risks. Principle #12 requires management to implement control activities through policies. As detailed below, with these safeguards in place, we believe the NCUA has appropriately responded to risks associated with managing the examination burden on credit unions.

Details

As documented in the Background section of this report, the NCUA has implemented a number of programs/initiatives and taken actions including the SCUPEP, EFI, Alternating Examination Program, Virtual Examination Program, and Offsite Exam Procedures that have impacted the examination burden on credit unions. We also determined the NCUA had safeguards in place, including criteria for extended examination cycles, the ability to request additional examination hours and adjust examination plans when circumstances warrant, and the review and approval of budgets. Additional details about these safeguards are discussed below.

Examiners Can Extend Examination Cycles for Lower-Risk Credit Unions

Several recommendations from the EFI addressed examination cycles. The NSPM states a federal credit union is eligible for an extended examination cycle (an examination start date 14-20 months from the completion date of the last examination) only if the credit union meets all the criteria below as of the last examination. Federal credit unions that meet these criteria signify credit unions with a lower risk associated with them.

- CAMELS code 1 or 2, both in the composite and the management rating component,
- Assets less than \$1 billion,
- “Well capitalized” per Prompt Corrective Actions regulations,¹²
- No outstanding Document of Resolution¹³ items related to significant recordkeeping deficiencies, and

¹² Prompt corrective action establishes the capital measures and capital levels that are used for determining appropriate supervisory actions for corporate credit unions that are not adequately capitalized. 12 C.F.R. § 704.4

¹³ A Document of Resolution identifies problems that management must begin to address immediately or within a compressed timeframe due to the risk associated with the problem.



- Not operating under a formal or informal enforcement or administrative order such as a Cease and Desist Order, Letter of Understanding and Agreement,¹⁴ Preliminary Warning Letter,¹⁵ or Prompt Corrective Action directive.

The NSPM requires federally insured, state-chartered credit unions to receive an NCUA examination based on risk and emerging trends or on a sample basis as part of the NCUA's overall due diligence. The Regions are required to examine each federally insured, state-chartered credit union at least once every 5 years. The NSPM also states federally insured, state-chartered credit unions that meet any one of the criteria below as of the last examination are required to receive an NCUA examination with a start date 8-12 months from the completion of the last NCUA examination. Federally insured, state-chartered credit unions with these asset sizes and CAMELS ratings signify credit unions with a higher risk associated with them.

- Assets greater than \$1 billion,
- Composite NCUA CAMELS code 4 or 5 with assets greater than \$50 million, or
- Composite NCUA CAMELS code 3 with assets greater than \$250 million.

We determined limiting extended examination cycles to lower-risk credit unions was an NCUA safeguard.

Examiners Can Request Additional Examination Hours

The NCUA's Examination Scope Instruction 5000.20 (Rev. 15)¹⁶ stated that examiners performing SCUEP examinations can request supervisor approval for additional hours to complete the examination and that the expectation is all reasonable and supported requests for additional time will be approved. Also, the NSPM states examiners should contact their supervisor if they need additional time to complete an examination, supervision contact, review of state examination, Risk Analysis and Trending Evaluation review, or any other examination or supervision-related activity.

As previously mentioned, 81 percent (13 of 16) of the examiners who responded with a Yes or No answer to our question on reluctance to request additional hours told us they had not been reluctant to ask their SE for additional hours. In addition, 46 percent of those examiners told us they had not had issues with their SE approving their requests for additional hours.

¹⁴ A Letter of Understanding and Agreement lists a credit union's specific material problems and the corrective actions necessary to resolve them. It formally requests that officials agree to the listed actions in lieu of the agency taking formal administrative action.

¹⁵ A Preliminary Warning Letter is drafted when a credit union's problems are serious and/or persistent and a credit union's board is unwilling to sign a letter of understanding and agreement. It is a warning of potential formal administrative action if corrective action is not taken.

¹⁶ Issued January 20, 2023.



We determined the ability and willingness of examiners to ask for additional examination hours was an NCUA safeguard.

Examiners Can Adjust Examination Hours When Warranted

The NSPM requires examination staff to monitor and supervise federally insured credit unions consistent with their size, complexity, condition, and timing of the next examination. At least quarterly, examination staff are required to re-evaluate their supervision plans for each assigned credit union based on current information and update the NCUA Projected Future Contact Hours section of the Examinable Entity Form,¹⁷ as necessary. Examination staff may change their examination and supervision plans at any time if circumstances warrant, after consulting with the assigned field supervisor.

Officials from ONES and the Regions told us the budget is a guide and examination hours are reviewed and adjusted as needed throughout the year. Adjustments to examination hours may be made due to CAMELS ratings going up or down, supervision plans changing, increasing risk at a credit union, or FTEs changing. During our review, we identified one federal credit union where examiners had not budgeted examination hours in 2022 for the 2023 examination year. However, based on requirements in the NSPM, examiners correctly scheduled an examination for 2023 because they downgraded the Management component of CAMELS to 3 based on the 2022 examination. In addition, we also identified a federally insured, state-chartered credit union that met the criteria to extend its examination cycle and was eligible for not having examination hours budgeted for in 2024. However, we learned that due to examiner and SE concerns with this credit union, they did budget examination hours for 2024.

NCUA's Examination Scope Instruction 5000.20 (Rev. 15) provides that examiners, with concurrence from their supervisor, may convert a SCUEP exam to a risk-focused examination based on the assessment of risk. It also states how decisions about the appropriate type of examination should be based on examiner experience and a credit union's product and service offerings, operations, current CAMELS ratings, and likelihood of downgrade to a CAMELS 4 or 5.

We determined the review and adjustment of examination plans due to changing circumstances represented an NCUA safeguard.

Budgets Are Subject to Review and Approval

E&I's 2024 Resource Budget Instruction Memo, among other things, describes the responsibilities of NCUA personnel involved in the budgeting process, which includes:

- Field supervisors reviewing and discussing with staff, where necessary, the recommended examination and supervision hours for credit unions assigned to their group, paying

¹⁷ There is an Examinable Entity Form for every credit union in MERIT, where users can view credit union profile information, including financial analytics, outside of an open examination.



particular attention to instances when an examiner has significantly changed the recommended hours from prior years.

- ARDPs and the ONES Deputy Director reviewing the proposed hours budgeted and making refinements as needed to ensure region-wide consistency.
- Regional Directors and the ONES Director reviewing, modifying as needed, and concurring with the prepared workload plans.
- E&I reviewing the Regions' and ONES program recommendations for consistency and compatibility with the expectations set by the NCUA Board.

As documented in the Background section of this report, NCUA officials informed us that SEs and regional and ONES executives all participate in the reviewing and approval process. During our audit, we reviewed MARS and determined SEs were reviewing the examination hours recommended by the examiners.

Based on the information presented above, we determined the NCUA had safeguards in place to protect the credit union system, credit union members, and the SIF while appropriately managing the examination burden on credit unions. Therefore, we are not making a recommendation to NCUA management.

Comparison of FDIC and NCUA Examination Hours

As part of this audit, we obtained and reviewed an NCUA study conducted by the NCUA's E&I in September 2021 comparing resource budgets between the NCUA and the Federal Deposit Insurance Corporation (FDIC) for financial institutions with CAMELS 1 or 2 ratings. The study compared the average number of examination hours the FDIC used from 2018-2020 to the average number of examination hours the NCUA budgeted for 2022.

Details

E&I compared the average actual examination hours (safety and soundness and Bank Secrecy Act) for years 2018 through 2020 of FDIC-examined institutions that were rated CAMELS 1 and 2 to the NCUA's average budgeted hours for examinations scheduled for 2022 for CAMELS 1 and 2 rated credit unions. The comparison was done for six asset size categories: under \$50 million, \$50 to \$100 million, \$100 to \$250 million, \$250 to \$500 million, \$500 million to \$1 billion, and \$1 billion to \$10 billion. Comparing the NCUA's average budgeted hours for 2022 examinations as a percentage of FDIC's average actual examination hours across the 3-year period from 2018-2020, the NCUA budgeted significantly fewer examination hours in each asset size category than the FDIC used. For example, for CAMELS 1 rated institutions with less than \$50 million in assets, the NCUA budgeted 15 percent of the average number of actual hours the FDIC used to examine comparable asset-sized banks from 2018 through 2020. Also, for CAMELS 1 rated institutions with \$500 million to \$1 billion in assets, the NCUA budgeted 38 percent of the average actual hours the FDIC used to examine banks of this asset size.



During our audit, we benchmarked with the FDIC and determined there were several differences between the FDIC and the NCUA that at least partially explained the difference in examination hours used by the FDIC (averaged over a 3-year period) and examination hours budgeted for 2022 by the NCUA. These included differences in the quantity of products and services offered, what was counted as examination hours, and resource allocation processes.

Different Types of Products and Services Offered

We determined one difference between FDIC-examined banks and NCUA-examined credit unions is that banks tend to offer more products and services. Banks offer more of a variety of loans and other financial products and services, while credit unions tend to stick with a few core offerings, such as deposit accounts, credit cards and loans. Many banks provide investment accounts and financial advisory services in addition to standard banking products. In benchmarking with FDIC, an official with its Division of Risk Management Supervision told us approximately one-quarter of a bank examination is spent on reviewing asset quality, which involves transaction testing (reviewing individual loan files). The same FDIC official also told us FDIC examiners always perform testing over individual loan files to determine whether banks follow their internal policies and procedures. The official explained banks tend to offer more lending products than credit unions, which may partially explain why the FDIC spends more hours conducting examinations than the NCUA. In addition, an FDIC official told us banks focus more on commercial and commercial real estate loans while credit unions typically focus on personal loans. The review of commercial loans can be more labor intensive than personal loans due to complexity.

Our research into differences between banks and credit unions also disclosed that international banking services and products are not common within credit unions. The FDIC's Risk Management Manual of Examination Policies contains a section on international banking. The manual states that while the number of U.S. banks involved in international finance is relatively small in comparison to the overall number of U.S. banks, many large institutions have notable cross-border exposure and significant international activities. Moreover, in certain markets, a considerable number of smaller banks allocate significant resources to international banking. The FDIC's manual also states FDIC examiners must review and understand international activities when assessing a bank's overall condition. We confirmed with an NCUA official that international banking is uncommon in credit unions. We believe this may also partially explain why the FDIC spends more hours on examinations than does the NCUA.

Differing Inclusion of Examination Activities

Our benchmarking with FDIC officials also identified a difference in how each regulator views which activities should be included as examination hours. An FDIC official told us the nature of the activity being performed determines whether an individual's time is considered as part of the examination hours. The official explained it does not matter if the person performing the activity is a trainee, commissioned examiner, subject matter expert, a specialist, or an SE; the time they spend performing certain activities will be included in the examination hours for the bank. One of the activities the FDIC includes in its examination hours calculation is the time bank



examiners spend performing pre-examination planning. In contrast, the NCUA budgets those hours in a separate category of hours called pre-examination planning. Another difference we identified is how each regulator treats the time SEs spend on an examination. Both the FDIC and the NCUA categorize SEs as first line supervisors. If an FDIC SE performs certain activities for a particular bank examination, those hours are included in FDIC's actual examination hours. However, we learned during our audit that NCUA's SEs do not charge time to examinations under their purview. Therefore, the budgeted examination hours NCUA examiners enter into MARS do not include SE hours. We believe these two differences also contribute to FDIC's actual examination hours being greater than NCUA's budgeted examination hours for financial institutions within the same asset category.

Differing Resource Allocation Processes

Finally, our benchmarking with FDIC identified another difference between the FDIC and the NCUA – the resource allocation process. We learned during our audit that the FDIC annually uses a National Examiner Staffing Model as the starting point for its resource budgeting. Specifically, the FDIC uses a top-down approach to resource budgeting. Through use of the FDIC's model, the Division of Risk Management Supervision gives the regions the total number of FTEs for each territory in the region, which the model estimates are needed to staff the projected point-in-time examinations for each territory within each region. Each region then allocates those FTEs to banks scheduled for an examination as it sees fit. The FDIC's resource budgeting process does not predetermine a set number of hours it plans on using to examine each bank. As described in the Background section of this report, the NCUA's approach is a bottom-up approach to develop the budgeted examination hours for each credit union that it plans to examine. The NCUA examiners and SEs establish the number of examination hours budgeted for each credit union to be examined in the coming cycle. Because the FDIC and the NCUA use such different approaches when conducting their annual resource allocation processes, we are not certain whether the difference in approaches contributes to the FDIC's actual examination hours significantly exceeding the NCUA's budgeted examination hours. However, we believe that a bottom-up approach to establishing examination hours is a solid approach and will deliver an accurate estimate of examination hours. This is borne out by our testing mentioned earlier, where we determined there was only a 2.2 percent difference between what NCUA examiners budgeted and the actual number of examination hours expended. We have concluded that NCUA was effective in establishing examination hours and would not recommend changing its approach.



OBJECTIVES, SCOPE, AND METHODOLOGY

We developed our objectives for this engagement based on OIG's 2023 Annual Performance Plan. Specifically, our objectives were to determine: (1) the NCUA's effectiveness in establishing examination hours, and (2) whether the NCUA ensured proper regulatory safeguards remained in place to protect the credit union system, credit union members, and the SIF while appropriately managing the examination burden on credit unions.

To accomplish our audit, we performed fieldwork with information obtained from various NCUA sources relevant to the NCUA's examination hours and safeguards in place to protect the credit union system, credit union members, and the SIF. The scope of our audit covered the NCUA's budgeting of examination hours for 2023 and 2024 and the NCUA's programs/initiatives from 2012 to June 2022 that have impacted the examination burden on credit unions. To achieve our objectives, we:

- Reviewed the NCUA's NSPM, E&I guidance, and regional guidance on the resource budgeting process.
- Interviewed E&I, ONES, and regional personnel and benchmarked with officials within the FDIC's Division of Risk Management Supervision.
- Obtained an understanding of the NCUA's and the FDIC's processes for budgeting examination hours.
- Sampled natural person credit unions supervised by NCUA's Regions and ONES and tested for the establishment of examination hours in MARS. We used a non-statistical random sample of credit unions supervised by the three Regions and ONES and reviewed the budgeting of examination hours for those credit unions. In each of the three Regions and ONES, we selected both federally insured credit unions and federally insured, state-chartered credit unions. To cover regionally supervised federally insured credit unions eligible for the SCUEP, we selected federally insured credit unions from the asset-size range of under \$50 million (SCUEP eligible) as well as federally insured credit unions with greater than \$50 million in total assets. We used a random number generator to select 10 credit unions from each region. We randomly selected four credit unions supervised by ONES, bringing our total sample of credit unions tested to 34.
- Compared actual examination hours to budgeted examination hours for examinations completed from February 1, 2023, to December 31, 2023, for credit unions that had examination hours budgeted. We used the MARS report, Budget Exam Hours Compared to Actual Last Exam Hours, to perform this comparison.



- Obtained an understanding of various NCUA programs/initiatives and actions taken that have or may have impacted the examination burden on credit unions by reviewing relevant NCUA documents.
- Evaluated internal control over the NCUA's resource budgeting process for examination hours.

We did not rely on computer-processed data from NCUA systems to answer the audit objectives. While we did review budgeted examination hours documented in MARS to answer the first objective, those hours were manually entered into MARS by examiners and SEs. We also relied on interviews and correspondence with NCUA officials to assess the validity of the data and confirm its reliability.

We conducted this audit from August 2023 through February 2024 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. We assessed the effectiveness of internal controls that we determined were significant to the audit objectives. Specifically, we assessed 4 of the 5 internal control Components and 5 of the 17 associated underlying Principles defined in the Government Accountability Office's Standards for Internal Control in the Federal Government.¹⁸ We summarize in Table 2 below the Components and Principles we assessed.

Table 2: Internal Control Components and underlying Principles Assessed

Component: Control Environment
Principle #3 – Establish Structure, Responsibility and Authority
Component: Risk Assessment
Principle #7 – Identify, Analyze, and Respond to Risks
Component: Control Activities
Principle #10 – Design Control Activities
Principle #12 – Implement Control Activities
Component: Information and Communication
Principle #15 – Communicate Internally

¹⁸ The Standards for Internal Control in the Federal Government organizes internal control through a hierarchical structure of 5 components and 17 principles. The five components, which represent the highest level of the hierarchy, consist of the Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. The 17 principles support the effective design, implementation, and operation of the components, and represent the requirements for establishing an effective internal control system.



We determined the internal controls that are significant to the audit objectives have been appropriately addressed by the NCUA. However, because our audit was focused on these significant internal control Components and underlying Principles, it may not have disclosed all internal control deficiencies that may have existed at the time of this audit.

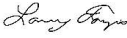


NCUA MANAGEMENT RESPONSE



National Credit Union Administration
Office of the Executive Director

SENT VIA EMAIL

TO: Inspector General James Hagen
FROM: Executive Director Larry Fazio 
SUBJ: Draft Report for the OIG Audit of the NCUA's Examination Hours
DATE: June 17, 2024

Thank you for the opportunity to review the OIG's draft report *Audit of the NCUA's Examination Hours*. The audit determined the NCUA was effective in establishing examination hours and had safeguards in place to protect the credit union system, credit union members, and the National Credit Union Share Insurance Fund while appropriately managing the examination burden on credit unions. The draft report does not make any recommendations.

We agree with the draft report's conclusions. Thank you for the opportunity to comment. If you have any questions regarding this response, please contact Shameka Sutton at (703) 548-2485 or ssutton@ncua.gov.

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



ACRONYMS AND ABBREVIATIONS

Acronym	Term
ARDP	Associate Regional Director of Programs
CAMELS	[C]apital Adequacy, [A]sset Quality, [M]anagement, [E]arnings, [L]iquidity, and [S]ensitivity to Market Risk
E&I	Office of Examination and Insurance
EFI	Exam Flexibility Initiative
FDIC	Federal Deposit Insurance Corporation
FTE	Full-Time Equivalent
GAO	Government Accountability Office
MARS	Management Automated Resource System
MERIT	Modern Examination and Risk Management Identification Tool
NCUA	National Credit Union Administration
NSPM	National Supervision Policy Manual
OIG	Office of Inspector General
ONES	Office of National Examinations and Supervision
RD	Regional Director
SCUEP	Small Credit Union Examination Program
SE	Supervisory Examiner
SIF	National Credit Union Share Insurance Fund
SSA	State Supervisory Authority
WCC	Work Classification Code