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Examination of Financial Statements of the National Credit Union Administration for the Fiscal Years Ended June 30, 1976 and 1975. FOD-77-6; B-164031(4). May 23, 1977. 29 pp.

Report to the Congress; by Robert F. Keller, Acting Comptroller General.

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Organization Concerned: National Credit Union Administration.

Congressional Relevance: House Committee on Banking, Currency and Housing; Senate Committee on Banking, Housing and Urban Affairs; Congress.

Authority: Federal Credit Union Act (12 U.S.C. 1751 et seq.; 12 U.S.C. 1787(a)(2), 1787(h), 1787(i)(1)).

Examination of the financial statements of the National Credit Union Administration (NCUA) for the 1975 and 1976 fiscal years showed that the NCUA needs to improve certain aspects of its operations. Findings/Conclusions: GAO cannot express an opinion on the reasonableness of assets acquired from liquidating credit unions of \$7,162,965 and \$7,076,466 for fiscal years 1976 and 1975, respectively, or of the allowance for doubtful accounts of \$4,558,507 and \$4,044,049 and financial expenses of \$723,963 and \$554,358 for fiscal years 1976 and 1975, respectively. In addition, liquidation expense was not fairly presented in fiscal year 1975. With the exceptions of these items, the share insurance fund's financial statements present fairly the fund's financial position at June 30, 1976 and 1975, and the results of its operations and the changes in financial position for the years then ended, in conformity with the principles and standards of accounting prescribed by the Comptroller General. Recommendations: The Administrator of the NCUA should continue efforts to eliminate uncollectable loans from the accounts and establish an allowance for doubtful accounts based on the collectability of the remaining loans, and should periodically evaluate the collectability of its loan portfolio and develop a more accurate method of estimating losses as soon as adequate program experience is available. The Administrator should also expand the scope of the internal audit work performed in the Washington headquarters to include all Credit Union Administration activity and related management controls. (Author/SC)

02180 2510



REPORT TO THE CONGRESS

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

Examination Of Financial Statements Of The National Credit Union Administration For The Fiscal Years Ended June 30, 1976 And 1975

The National Credit Union Administration needs to improve certain aspects of its operations. The Administrator should

- complete efforts to identify and write off uncollectable loans,
- base the allowance for doubtful accounts for assets acquired on program experience as soon as adequate experience is available, and
- expand the scope of the internal audit work.

GAO has qualified its opinion on the Credit Union Administration's share insurance fund, because the valuation of certain assets could not be verified and because certain expenses were charged directly to retained earnings rather than expense.

The Administrator has agreed to take appropriate action to resolve all matters noted in this report.

FOD-77-6

MAY 23, 1977



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164031(4)

To the President of the Senate and the
Speaker of the House of Representatives

This report summarizes the results of our examination of the financial statements of the National Credit Union Administration for fiscal years 1976 and 1975.

We made our examination pursuant to the Federal Credit Union Act, as amended (12 U.S.C. 1752a(f) and 1789(b)(2) (1970)).

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of the Treasury; and the Administrator, National Credit Union Administration.

By K. H. ...
ACTING Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

EXAMINATION OF FINANCIAL
STATEMENTS OF THE NATIONAL
CREDIT UNION ADMINISTRATION
FOR THE FISCAL YEARS ENDED
JUNE 30, 1976 AND 1975

D I G E S T

The Federal Credit Union Act, as amended, requires GAO to audit the National Credit Union Administration's operating fund and share insurance fund.

OPERATING FUND

In GAO's opinion, the Credit Union Administration's financial statements present fairly the operating fund's financial position at June 30, 1976 and 1975, the results of its operations and the changes in its financial position for the years then ended, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States.

SHARE INSURANCE FUND

GAO cannot express an opinion on the reasonableness of:

- Assets acquired from liquidating credit unions of \$7,162,965 and \$7,076,486 for fiscal years 1976 and 1975, respectively, because the limited response to our confirmation requests and the inclusion of uncollectable loans prevented us from making any projections concerning the validity of the amounts owed by individual borrowers on their loans. (See pp. 9 and 10.)

- Allowance for doubtful accounts of \$4,558,507 and \$4,044,049 and financial expenses of \$723,963 and \$554,358 for fiscal years 1976 and 1975, respectively. The data used to compute the estimated losses on purchased loans was not based on program experience, because sufficient program experience was not available. (See pp. 11 and 12.)

In addition, liquidation expense was not fairly presented in fiscal year 1975. Because certain liquidation expenses were charged directly to retained earnings, the account was understated by about \$1 million and resulted in net income being overstated by a corresponding amount. (See pp. 12 and 13.)

In our opinion, except for assets acquired from liquidating credit unions, allowance for doubtful accounts, and financial expenses for fiscal years 1976 and 1975, and liquidation expense for fiscal year 1975 discussed above, the share insurance fund's financial statements present fairly the fund's financial position at June 30, 1976 and 1975, and the results of its operations and the changes in financial position for the years then ended in conformity with the principles and standards of accounting prescribed by the Comptroller General of the United States.

GAO recommends that the Administrator:

- Continue efforts to eliminate uncollectable loans from the accounts and establish an allowance for doubtful accounts based on the collectability of the remaining loans. (See p. 12.)
- Periodically evaluate the collectability of its loan portfolio and develop a more accurate method of estimating losses as soon as adequate program experience is available. (See p. 12.)

In addition, the National Credit Union Administration limited internal audit work performed in its Washington headquarters to financial operations and did not include all Washington headquarters activities and related management controls. GAO recommends that the Administrator expand the scope of the internal audit work performed in the Washington headquarters to include all Credit Union Administration activity and related management controls. (See pp. 8 and 12.)

The Administrator has agreed to act on GAO's recommendations.

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CHAPTER 1

INTRODUCTION

The National Credit Union Administration is an independent executive branch agency which charters, supervises, and examines Federal credit unions (12 U.S.C. 1751 et seq. (1970) and supp. V (1975)). The National Credit Union Administration also insures member savings in Federal credit unions and qualified State-chartered credit unions. The maximum insurance on each member account is \$40,000, effective November 27, 1974.

The Credit Union Administration's insurance functions are separated from its other functions of chartering, supervising, and examining credit unions. Insurance functions are financed principally by assessments against insured credit unions and from earnings on investments in U.S. Government interest-bearing securities.

At June 30, 1976, the share insurance fund had accumulated net income of \$63 million. This was equivalent to 0.2 percent of estimated insured savings of \$19.7 billion in Federal credit unions and \$8.7 billion in federally insured State-chartered credit unions at June 30, 1976. In addition to the accumulated net income, the fund has a \$100 million borrowing authority from the U.S. Treasury. This borrowing authority has not been exercised.

At June 30, 1976, 12,829 Federal credit unions and 3,264 State-chartered credit unions were insured under the share insurance program.

The Credit Union Administration's chartering, supervising, and examining functions are administered under an operating fund and are financed by fees received from Federal credit unions for these services and from the share insurance fund for work related to share insurance. At June 30, 1976 and 1975, the operating fund had accumulated retained earnings of \$3.2 and \$2.3 million, respectively.

MANAGEMENT AND ADMINISTRATION

The Administrator, National Credit Union Administration, directs the activities of both the operating and the share insurance funds. The Administrator, appointed by the President with the advice and consent of the Senate, serves at the pleasure of the President.

A National Credit Union Board acts in an advisory capacity to the Administrator. The Board consists of the Chairman, who serves at the pleasure of the President, and one member from each of the six Credit Union Administration regions appointed by the President with the advice and consent of the Senate. Board members, except the Chairman, serve 6-year terms.

CHAPTER 2

SUPERVISION AND EXAMINATION OF INSURED

CREDIT UNIONS

FEDERAL CREDIT UNIONS

The Credit Union Administration examines Federal credit unions to determine their financial condition and compliance with applicable laws and regulations. It identifies potential problems in management and operations and assists the credit unions' management in their resolution. The examination is also the principal method used to determine if a Federal credit union continues to qualify for share insurance. In fiscal year 1976 the Credit Union Administration made 12,796 examinations of Federal credit unions.

The Credit Union Administration also has an early warning system which is designed to supplement its examinations; serve as a protective device for the insurance fund; and help identify Federal credit unions that might be verging on financial and management difficulties or that are, in fact, experiencing such difficulties. The system provides for the input of certain financial and management data obtained from examinations and reports submitted at required intervals by Federal credit unions. Subsequent data obtained by the examiners or submitted by the credit unions are then electronically compared with the previous data to determine if adverse trends have developed or persisted. In either case, the Credit Union Administration will assist the credit unions in overcoming their problems.

STATE-CHARTERED CREDIT UNIONS

Although State-chartered credit unions are insured under the share insurance program, the Credit Union Administration does not anticipate examining them. Instead, it uses, to the extent possible, the examination reports and other information furnished by State supervisory agencies or other organizations examining State-chartered credit unions.

In April 1974 the Administrator instituted a continued insurability program for federally insured State-chartered credit unions. This program, a cooperative effort with State supervisory agencies, provides for the submission of information by State examiners concerning areas of noncompliance with Credit Union Administration rules, regulations, and other data. The data is evaluated by the Credit Union Administration's regional offices to determine where action is needed to

correct problems threatening continued insurability. Corrective action is taken by or in cooperation with the State supervisory agencies.

PROBLEM CREDIT UNIONS

The Credit Union Administration classifies credit unions it insures as unsatisfactory, weak, satisfactory, or good. An unsatisfactory credit union has critical problems requiring personal supervision by an examiner. A weak credit union has problems which could require further attention. A satisfactory credit union has certain factors present which could evolve into problems in the future. A good credit union has no major problems.

The number of Federal credit unions in each classification and the Credit Union Administration's estimate of insured savings as of last examination at June 30, 1975 and 1976, are shown below.

	<u>Number of Federal credit unions</u>		<u>Estimated insured savings</u>	
	<u>6/30/76</u>	<u>6/30/75</u>	<u>6/30/76</u>	<u>6/30/75</u>
			(000,000 omitted)	
Good or satisfactory	8,584	8,517	\$15,779	\$14,828
Weak	3,553	3,569	1,734	1,605
Unsatisfactory	<u>692</u>	<u>747</u>	<u>255</u>	<u>200</u>
Total	<u>12,829</u>	<u>12,833</u>	<u>\$17,768</u>	<u>\$16,633</u>

Reports received on insured State-chartered credit unions are evaluated using similar criteria as that applied to Federal credit unions. The Credit Union Administration began classifying insured State-chartered credit unions by problem severity in fiscal year 1976. At August 27, 1976, 126 insured State-chartered credit unions were considered to be unsatisfactory. The number of these credit unions in each classification and the Credit Union Administration's estimate of insured savings as of last examination at December 31, 1975, are shown below.

	Number of insured State credit unions <u>12/31/75</u>	Estimated insured savings <u>12/31/75</u> (000,000 omitted)
Good or satisfactory	2,641	\$6,022
Weak	624	957
Unsatisfactory	<u>182</u>	<u>338</u>
Total	<u>3,447</u>	<u>\$7,317</u>

We reviewed a sample of Federal credit union examination reports and insured State credit union examination records for fiscal years 1976 and 1975. We assessed the Credit Union Administration's examination classification procedures that identify problem credit unions. Before our fiscal year 1975 audit, we were not allowed complete access to these records and could not make such an assessment.

We analyzed and reviewed reports and related documents pertaining to a sample of credit unions in all four classifications, and we discussed the results with Credit Union Administration officials. On the basis of our review, we found that problem credit unions were being identified, the classification of credit unions appeared reasonable, and additional supervisory attention was being given to those credit unions having problems.

CHAPTER 3

LIQUIDATION OF INSURED CREDIT UNIONS

During fiscal years 1976 and 1975, 196 and 183 Federal credit unions, respectively, entered into voluntary liquidation which does not require any payment of shareholder accounts by the share insurance fund. Solvency and a majority vote of credit union members are required to enter voluntary liquidation. The Administrator, in order to expedite the voluntary liquidation for 21 and 19 of these Federal credit unions in fiscal years 1976 and 1975, respectively, guaranteed their loans purchased by other credit unions, credit union trade associations, and financial institutions under authority granted to him by the Federal Credit Union Act (12 U.S.C. 1788 (1970) and supp. V (1975)).

At June 30, 1976, a cumulative total of 118 guarantee agreements created a contingent liability of \$5,284,206 on the insurance fund. The contingent liability at June 30, 1975, was \$2,550,295 from 83 guarantee agreements.

The Administrator also placed 122 and 147 Federal credit unions in involuntary liquidation during fiscal years 1976 and 1975 due to insolvency. Members' shareholdings in these credit unions totaled \$5.8 and \$8.4 million for the respective years.

In both fiscal year 1976 and 1975, six federally insured State-chartered credit unions, with total members' shareholdings of \$90,587 and \$397,497, respectively, were placed in liquidation by their State supervisors because of insolvency.

Since its inception in 1970, the share insurance fund has paid the following amounts to insured shareholders whose credit unions were involuntarily liquidated due to insolvency.

<u>Fiscal year</u>	<u>Number of liquidations</u>	<u>Total annual payout</u>
1971	-	\$ -
1972	4	1,862
1973	50	1,365,671
1974	100	2,838,151
1975	153	5,542,265
1976	128	7,526,882

Most involuntary liquidations involve small credit unions. During fiscal year 1976, almost three-quarters of the 128 involuntary liquidations concerned credit unions with assets of less than \$50,000.

The largest credit union which was placed into involuntary liquidation during either fiscal year 1976 or 1975 had assets of \$1,139,629. Total members' shareholdings in the credit union amounted to \$507,549, and the share insurance fund had paid \$480,605 through June 30, 1976.

The major reasons for the voluntary and involuntary liquidation of Federal and insured State credit unions during fiscal years 1976 and 1975 were

- poor financial position.
- loss of membership,
- inability to obtain officials, and
- mergers.

CHAPTER 4

INTERNAL AUDIT

The Credit Union Administration's internal audit staff periodically reviews its regional offices and audits the financial operations. The reviews of the regional office cover operations, such as examination program completion, workflow, personnel and administrative management, and public affairs. The audit of financial transactions is made at the Credit Union Administration's Washington headquarters and consists of a review of various accounting procedures, internal controls, and selected financial transactions.

We reviewed the internal audit work performed for fiscal years 1975 and 1976 which pertained to the Credit Union Administration's financial operations and relied upon it to the extent practicable to reduce the scope of our audit.

We noted that the internal audit work completed in the Credit Union Administration's Washington headquarters was restricted to the audit of the Credit Union Administration's financial operations. To be of maximum usefulness, the scope of the internal auditor's activity should not be restricted to one area. It should extend to all Washington headquarters activities and related management controls to ascertain whether they are functioning in accordance with their design and are functioning effectively. The internal audit function can provide a highly valuable service to the Credit Union Administration by reviewing, appraising, and reporting on the extent and nature of internal compliance with management's policies, plans, and procedures, as well as with applicable legal and external regulatory requirements.

RECOMMENDATION

We recommend that the Administrator expand the scope of the internal audit work performed in the Washington headquarters to include all Credit Union Administration activity and related management controls.

AGENCY COMMENTS

The Administrator told us that our recommendation was being studied. During subsequent audits, we will evaluate the action taken by the Credit Union Administration.

CHAPTER 5

COMMENTS ON THE FINANCIAL STATEMENTS

ASSETS ACQUIRED FROM
LIQUIDATING CREDIT UNIONS

The share insurance fund's statement of financial condition as of June 30, 1976 and 1975, (sch. 4), includes assets acquired from Federal credit unions with an applicable allowance for doubtful accounts as shown below.

	<u>June 30, 1976</u>	<u>June 30, 1975</u>
Assets acquired from liquidating credit unions	\$7,162,965	\$7,076,486
Allowance for doubtful accounts	<u>4,558,50.</u>	<u>4,044,049</u>
Total	<u>\$2,604,458</u>	<u>\$3,032,437</u>

These assets consisted primarily of loans purchased from liquidating credit unions under the Credit Union Administration's loan guarantee and direct purchase programs described below.

Loan guarantee program

The Administrator is authorized by the Federal Credit Union Act (12 U.S.C. 1788(a)(2) (1970), supp. V (1975), and supp. III (1973)) to guarantee loans of liquidating credit unions purchased by other organizations to expedite distribution of the assets. Upon expiration of the guarantee agreement, the Administrator repurchases any guaranteed loans of the liquidating credit unions not collected by the organizations to which the Administrator made the guarantee. In fiscal years 1976 and 1975, about \$585,000 and \$710,000, respectively, were paid to repurchase loans.

Direct purchase program

Under the direct purchase program, the Administrator, by authority of the Federal Credit Union Act (12 U.S.C. 1787(i)(1) (1970) and supp. V (1975)), may purchase the assets of insured credit unions which are closed for bankruptcy or insolvency. The act further provides that, when the Administrator is acting as the liquidating agent, he may not purchase assets without court approval.

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The amount shown on the share insurance fund's comparative statement of financial condition for assets acquired from liquidating credit unions under these programs may be greatly overstated because the Credit Union Administration did not establish criteria to identify and write off any bad loans as uncollectable before March 1976, although an in-house collection activity was established in January 1974. After March 1976 the Credit Union Administration began writing off uncollectable loans. At June 30, 1976, 9,619 loans worth \$1,750,902 had been written off. However, not all uncollectable loans were written off by that date. As a result, the June 30, 1976 and 1975, balances for these assets include loan amounts which are uncollectable and have not been written off, such as loans due from borrowers who are now bankrupt.

In accordance with generally accepted auditing procedures, we attempted to determine the reasonableness of the assets acquired from liquidating credit unions by direct confirmation with individual borrowers. For each year, we selected a statistical sample of loans and requested borrowers to confirm the balance of their indebtedness as recorded on Credit Union Administration records. Followup requests were sent to those who did not respond to our initial request. The following schedule summarizes our confirmations.

	<u>FY 1976</u>	<u>FY 1975</u>
Number of loans in universe sampled	12,494	9,300
Number of loans in sample	436	459
Number responded:	91	150
Responses indicating agreement	69	113
Responses with exceptions	22	37

The remaining loans in our sample were either unanswered by borrowers or undeliverable by the United States Postal Service.

Because of the limited response to our confirmation requests, the inclusion of uncollectable loans, and our inability to satisfy ourselves as to the validity of the individual loan balances by other auditing procedures, we are unable to express an opinion as to the reasonableness of assets acquired from liquidating credit unions at June 30, 1976 and 1975.

Allowance for doubtful accounts
and financial expenses

The share insurance fund's comparative statement of financial condition as of June 30, 1976 and 1975 (sch. 4), includes, as a deduction from assets acquired from liquidating credit unions, an allowance for doubtful accounts of \$4,558,507 and \$4,044,049, respectively. In addition, the share insurance fund's comparative statement of income and expense for the period ended June 30, 1976 and 1975 (sch. 5), includes \$723,963 and \$554,358, respectively, for financial expenses which represent primarily the Credit Union Administration's estimate of possible fiscal year losses on assets acquired from liquidating credit unions.

During both fiscal year 1976 and 1975, the Credit Union Administration used different methods to estimate its expected loss on loans acquired under the loan guarantee program and the direct purchase program. The Credit Union Administration estimated that a certain percentage of loans purchased under the loan guarantee program would probably be uncollectable. However, estimates of uncollectable amounts for loans purchased under the direct purchase program represent the difference between the unpaid balance and the corresponding fair market value of the loans at the time of acquisition. Neither of these methods is based on actual experience.

In September 1975 the Credit Union Administration analyzed the loans acquired through the loan guarantee program and determined that the allowance for loss percentage on these loans was not sufficient. The Credit Union Administration increased the percentage from 80 to 95 percent on loans acquired after October 31, 1975, but did not make an adjustment for loans acquired before that date. Since the Credit Union Administration had about \$1,130,000 of loans acquired through the loan guarantee program at June 30, 1975, and an additional \$247,000 by October 31, 1975, the applicable allowances for doubtful accounts and for financial expense are understated by about \$170,000 and \$37,000 for fiscal years 1975 and 1976, respectively.

As mentioned above, estimates of uncollectable amounts on loans acquired under the direct purchase program are not based on program experience and are established at the time the loans are acquired. We found that the adequacy of the allowance for doubtful accounts on these loans had not been adjusted subsequent to the purchase of the loans. Generally, the allowance for doubtful accounts should be evaluated and adjusted periodically by considering such factors as loss experience, the condition of the loans at date of the financial statements, and general economic conditions.

The Credit Union administration believes it will take 3 years to gain enough program experience on which to base its estimates of uncollectable loans.

Since the Credit Union Administration has not based its estimates of losses on loans acquired under the loan guarantee and direct purchase programs on actual experience, we were unable to evaluate the adequacy of the estimates. We therefore cannot express an opinion on the reasonableness of the allowance for doubtful accounts on assets acquired from liquidating credit unions and related financial expense for fiscal year 1976 or 1975.

Recommendations

We recommend that the Administrator:

- Complete the effort to identify and eliminate uncollectable loans from the accounts and establish an allowance for doubtful accounts based on the collectability of the remaining loans.
- Periodically evaluate the collectability of its loan portfolio and develop a more accurate method of estimating losses as soon as adequate program experience is available.

Agency comments

The Administrator told us that a vigorous charge-off procedure had been implemented for all loans considered to be uncollectable. He said that subsequent GAO audits would reflect a higher return on loan account verifications. He said also that a policy was being developed to periodically review the adequacy of the allowance account based on program experience.

The Administrator's actions should resolve the problems concerning the allowance for doubtful accounts.

LIQUIDATION EXPENSE

Before February 1975, the Administrator's policy was to charge insurance payments made to credit union shareholders to expense in the fiscal year the payment was made and the Administrator's share of amounts realized from the liquidation of an insured credit union's assets to income in the fiscal year received. In our fiscal year 1974 report, we recommended that the Administrator revise this policy in order to provide better financial disclosure of the effect to

credit union liquidations on the financial position of the share insurance fund.

On February 1, 1975, the Credit Union Administration revised its accounting policy for involuntary liquidations of insured credit unions as follows. The Credit Union Administration establishes at date of liquidation the share insurance fund's total liability for insurance payments to credit union shareholders (shareholders payable) and the share insurance fund's expected loss (liquidation expense) on credit union liquidations. The Credit Union Administration also establishes the estimated portion (subrogated assets receivable) the share insurance fund is entitled to receive from the assets of a closed credit union.

We found that, in implementing the new accounting policy in February 1975 for involuntary liquidation, the Credit Union Administration had understated liquidation expense by about \$1 million for the period ended June 30, 1975. This also resulted in the share insurance fund's net income for the same period being overstated by a corresponding amount. The ending balance for retained earnings at June 30, 1975, of \$47,196,403 was not affected by the implementation of the new accounting policy because the liquidation expenses, applicable to fiscal year 1975, were charged directly to retained earnings, rather than fiscal year 1975 operations.

The amount shown for liquidation expense of \$79,588 in the comparative statement of income and expense for the period ended June 30, 1975, is not fairly presented. We believe that the liquidation expenses of \$1 million should have been charged to fiscal year 1975 operations rather than being charged directly to retained earnings. Fiscal year 1976 statements were not affected.

CHAPTER 6

SCOPE OF AUDIT AND OPINION ON FINANCIAL STATEMENTS

SCOPE OF AUDIT

We examined the operating fund's statement of financial condition at June 30, 1976 and 1975, and the related statements of income and expense and changes in financial position for the years then ended. We also examined the share insurance fund's statement of financial condition at June 30, 1976 and 1975, the related statements of income and expense, the changes in financial position and retained earnings for the years then ended, and the statement of analysis of the share insurance fund from the fund's inception through June 30, 1976.

We made our examination in accordance with generally accepted auditing standards and included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances and appropriate in view of the effectiveness of the system of internal control and the work done by the internal audit staff.

OPINION ON FINANCIAL STATEMENTS

The Credit Union Administration prepared the financial statements in this report (schs. 1 through 8). We prepared the notes to the financial statements.

Operating fund

In our opinion, the accompanying financial statements present fairly the operating fund's financial position at June 30, 1976 and 1975, and the results of its operations and the changes in its financial position for the years then ended, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States.

Share insurance fund

Assets acquired from liquidating credit unions were \$7,162,965 and \$7,076,486 in fiscal years 1976 and 1975, respectively. The limited response to our confirmation requests and the inclusion of uncollectable loans prevents us from making any projections concerning the validity of amounts owed by individual borrowers on their loans.

The allowances for doubtful accounts were \$4,558,507 and \$4,044,049 and financial expenses were \$723,963 and \$554,358

in fiscal years 1976 and 1975, respectively. The data used to compute the estimated losses on purchased loans was not based on program experience. (See p. 11.) In addition, we found that liquidation expense was not fairly presented in fiscal year 1975 because the account was understated by about \$1 million and resulted in net income being overstated by a corresponding amount for that year. However, because the expense was charged directly to retained earnings, the fiscal year 1976 statements were not affected. (See p. 12.)

In our opinion, except for assets acquired from liquidating credit unions, allowance for doubtful accounts, and financial expenses for fiscal years 1976 and 1975, and liquidation expense for fiscal year 1975, as discussed above, the accompanying financial statements present fairly the share insurance fund's financial position at June 30, 1976 and 1975, and the results of its operations and the changes in financial position for the years then ended, in conformity with the principles and standards of accounting prescribed by the Comptroller General of the United States.

NATIONAL CREDIT UNION ADMINISTRATIONOPERATING FUNDCOMPARATIVE STATEMENT OF FINANCIAL CONDITION (note 1)JUNE 30, 1976, AND JUNE 30, 1975

ASSETS

	<u>June 30, 1976</u>	<u>June 30, 1975</u>
CURRENT ASSETS:		
Cash:		
With the U.S. Treasury in transit and on hand	\$ 185,972	\$ 109,362
Accounts receivable and prepaid items	839	673
Accrued fees:		
Supervision fees	1,202,500	773,299
Examination fees	338,302	278,634
Travel advances	114,235	122,922
Prepaid expenses	5,592	-
Total current assets	<u>1,847,440</u>	<u>1,284,890</u>
FIXED ASSETS:		
Equipment	695,587	505,247
Less accumulated depreciation	<u>172,035</u>	<u>114,906</u>
Total net equipment	523,552	390,341
OTHER ASSETS:		
Reimbursements due from share insurance fund	<u>2,446,254</u>	<u>1,974,789</u>
Total assets	<u>\$4,817,246</u>	<u>\$3,650,020</u>
LIABILITIES AND RETAINED EARNINGS		
CURRENT LIABILITIES:		
Accounts payable	\$ 158,264	\$ 154,753
Accrued liabilities	453,225	350,659
Liability for advances from other agencies	73,427	74,963
Liability for accrued annual leave	<u>905,088</u>	<u>761,402</u>
Total current liabilities	1,590,004	1,341,777
OTHER LIABILITIES:		
Liability for agency cashier funds	<u>500</u>	<u>500</u>
Total liabilities	1,590,504	1,342,277
RETAINED EARNINGS:		
Reserve for claims	300,000	300,000
Current and prior years' earnings	<u>2,926,742</u>	<u>2,007,743</u>
Total retained earnings	<u>3,226,742</u>	<u>2,307,743</u>
Total liabilities and retained earnings	<u>\$4,817,246</u>	<u>\$3,650,020</u>

GAO's notes following schedule 3 are an integral part of this statement.

NATIONAL CREDIT UNION ADMINISTRATION
OPERATING FUND
COMPARATIVE STATEMENT OF INCOME AND EXPENSE
FOR THE FISCAL YEARS ENDED
JUNE 30, 1976, AND JUNE 30, 1975 (note 1)

	<u>Fiscal year 1976</u>	<u>Fiscal year 1975</u>
INCOME:		
Charter fees	\$ 9,140	\$ 9,140
Supervision fees (note 2)	2,528,977	1,880,412
Examination fees	<u>8,929,347</u>	<u>8,287,534</u>
Total income	\$11,467,464	\$10,177,086
OPERATING EXPENSES:		
Personnel compensation and benefits	7,836,740	7,428,982
Travel	1,132,929	1,073,240
Transportation of things	66,916	83,716
Rent and communications	774,553	690,651
Other contractual services	233,037	248,976
Supplies and materials	164,774	178,218
Depreciation of equipment	59,406	36,751
Annual leave	143,685	47,856
Other administrative expenses	<u>136,424</u>	<u>334,820</u>
Total expenses	<u>10,548,464</u>	<u>10,123,210</u>
Net income	\$ <u>919,000</u>	\$ <u>53,876</u>

GAO's notes following schedule 3 are an integral part of this statement.

NATIONAL CREDIT UNION ADMINISTRATIONOPERATING FUNDCOMPARATIVE STATEMENT OF CHANGES IN FINANCIAL POSITIONFOR FISCAL YEARS 1976 AND 1975 (note 1)

	<u>Fiscal year 1976</u>	<u>Fiscal year 1975</u>
FUNDS PROVIDED:		
Income from charter, supervision, and examination fees	\$11,467,464	\$10,177,086
Decrease in net working capital	<u>-</u>	<u>120,895</u>
Total funds provided	<u>\$11,467,464</u>	<u>\$10,297,981</u>
FUNDS APPLIED:		
Operating expenses, excluding depreciation	10,489,058	\$10,086,459
Purchase of equipment	192,617	119,443
Increase in amounts due from the share insurance fund	471,465	92,079
Increase in net working capital	<u>314,324</u>	<u>-</u>
Total funds applied	<u>\$11,467,464</u>	<u>\$10,297,981</u>

GAO's notes following this schedule are an integral part of the financial statements.

GAO NOTES TO FINANCIAL STATEMENTS

OPERATING FUND

1. Accounting policies

--Supervision fees applicable to the second half of a fiscal year are not received by the Credit Union Administration until the following fiscal year. Accordingly, the Credit Union Administration estimates a portion of the fees which is based on management forecasts of Federal credit union growth.

--Fixed assets are depreciated on a straight-line basis using a composite useful life of 10 years.

--Allocation of costs to the share insurance fund is based on the actual examining time spent on supervision activity.

2. By action of the Administrator, supervision fees for calendar years 1976 and 1975 were reduced 40 percent, except when the minimum fee was still required by the Federal Credit Union Act.

NATIONAL CREDIT UNION ADMINISTRATION

SHARE INSURANCE FUND

COMPARATIVE STATEMENT OF FINANCIAL CONDITION

JUNE 30, 1976, AND JUNE 30, 1975 (note 1)

ASSETS	<u>June 30, 1976</u>		<u>June 30, 1975</u>	
CURRENT ASSETS:				
Cash with U.S. Treasury and in transit	\$	539,435	\$	155,532
Accrued interest receivable		322,205		315,546
Accounts receivable		49,462		72,634
Assets acquired from liquidating credit unions (note 2)	\$7,162,965		\$7,076,486	
Less allowance for doubtful accounts	<u>4,558,507</u>	2,604,458	<u>4,044,049</u>	3,032,437
Subrogated assets receivable		<u>2,705,158</u>		<u>2,022,961</u>
Total current assets		6,220,718		5,599,110
INVESTMENTS IN U.S. GOVERNMENT SECURITIES				
		71,120,401		53,170,584
OTHER ASSETS:				
Bonds acquired from liquidating credit unions		750,000		750,000
Loans to insured credit unions (note 3)	122,302		175,321	
Less allowance for doubtful accounts	<u>85,997</u>	<u>36,305</u>	<u>-</u>	<u>175,321</u>
Total other assets		<u>786,305</u>		<u>925,321</u>
Total assets		<u>\$78,127,424</u>		<u>\$59,695,015</u>
LIABILITIES AND RETAINED EARNINGS				
CURRENT LIABILITIES:				
Amounts due to liquidating agents of insured credit unions		\$ -		\$ 464,714
Unapplied receipts		40,241		101,402
Shareholders payable (note 4)		1,113,577		1,169,136
Other trade accounts payable		<u>20,709</u>		<u>-</u>
Total current liabilities		\$ 1,174,527		\$ 1,735,252
DEFERRED SHARE INSURANCE PREMIUMS				
		10,915,542		8,361,353
OTHER LIABILITIES:				
Liability to the operating fund	\$2,446,255		\$1,974,789	
Liability for advances from another agency (note 5)	<u>383,460</u>	<u>2,829,735</u>	<u>427,218</u>	<u>2,402,007</u>
Total liabilities		14,919,804		12,498,612
CONTINGENT LIABILITIES (note 6)				
RETAINED EARNINGS:				
Current and prior years' earnings (sch. 7)		<u>63,207,620</u>		<u>47,196,403</u>
Total liabilities and retained earnings		<u>\$78,127,424</u>		<u>\$59,695,015</u>

GAO's notes following schedule 8 are an integral part of this statement. GAO's opinion on these statements appears on page 15.

NATIONAL CREDIT UNION ADMINISTRATION
SHARE INSURANCE FUND
COMPARATIVE STATEMENT OF INCOME AND EXPENSE
FOR THE FISCAL YEARS ENDED
JUNE 30, 1976, AND JUNE 30, 1975 (note 1)

	<u>Fiscal year 1976</u>	<u>Fiscal year 1975</u>
INCOME:		
Share insurance premiums	\$18,432,893	\$15,459,511
Income from U.S. Government securities	3,999,083	3,206,961
Interest income	264,275	185,077
Miscellaneous income	<u>65,687</u>	<u>12,788</u>
Total income	\$22,761,938	\$18,864,337
OPERATING EXPENSES:		
Personnel compensation and benefits	3,468,016	2,496,565
Travel	352,728	273,362
Other administrative expenses	984,002	451,615
Financial expenses	<u>723,963</u>	<u>554,358</u>
Total operating expenses	5,528,709	3,775,900
Liquidation expenses	<u>1,222,012</u>	<u>79,588</u>
Total expenses	<u>6,750,721</u>	<u>3,855,488</u>
Net income	<u>\$16,011,217</u>	<u>\$15,008,849</u>

GAO's notes following schedule 8 are an integral part of this statement.
GAO's opinion on these statements appears on page 15.

NATIONAL CREDIT UNION ADMINISTRATIONSHARE INSURANCE FUNDCOMPARATIVE STATEMENT OF CHANGES IN FINANCIAL POSITIONFOR FISCAL YEARS 1976 and 1975 (note 1)

	<u>Fiscal year 1976</u>	<u>Fiscal year 1975</u>
FUNDS PROVIDED:		
Insurance premiums	\$18,432,893	\$15,459,511
Investment income less amortized net discounts	2,359,101	1,974,577
Interest and miscellaneous income	329,962	197,865
Matured U.S. Treasury investments	49,492,636	46,003,947
Increase in deferred share insurance premiums	2,554,189	1,502,301
Increase in amounts due operating fund	471,466	92,079
Collection of loans and advances from credit unions	<u>139,017</u>	<u>241,869</u>
Total funds provided	<u>\$73,779,264</u>	<u>\$65,472,149</u>
FUNDS APPLIED:		
Operating expenses	\$ 5,528,709	3,775,900
Liquidation expenses	1,222,012	79,588
Bonds purchased from liquidating credit union	-	750,000
Purchase of U.S. Treasury investments	65,802,472	57,954,384
Payments to OEO liquidating credit union (note 5)	43,738	7,972
Increase in net working capital	<u>1,182,333</u>	<u>2,904,305</u>
Total funds applied	<u>\$73,779,264</u>	<u>\$65,472,149</u>

GAO's notes following schedule 8 are an integral part of this statement.
GAO's opinion on these statements appears on page 15.

NATIONAL CREDIT UNION ADMINISTRATIONSHARE INSURANCE FUNDSTATEMENT OF RETAINED EARNINGSFOR THE YEARS ENDED JUNE 30, 1976 and 1975 (note 1)

Retained earnings--June 30, 1974	\$31,968,078
Add:	
Net income per income statement (sch. 5)	15,008,849
Net adjustments resulting from change in accounting policy for involuntary credit union liquidation	<u>219,476</u>
Retained earnings--June 30, 1975	47,196,403
Add:	
Net income per income statement (sch. 5.)	<u>16,011,217</u>
Retained earnings--June 30, 1976	<u>\$63,207,620</u>

GAO's notes following schedule 8 are an integral part of this statement. GAO's opinion on these statements appears on page 15.

NATIONAL CREDIT UNION ADMINISTRATIONANALYSIS OF SHARE INSURANCE FUNDFROM JANUARY 1, 1971, TO JUNE 30, 1976 (note 1)

INCOME:

Insurance premiums	\$68,690,438
Income from U.S. Government securities	11,152,174
Assets recovered from liquidating credit unions	1,388,128
Other interest income	467,849
Miscellaneous income	<u>78,475</u>
Total income	<u>81,777,064</u>

EXPENSES:

Operating expenses	13,644,300
Share insurance payments to credit union shareholders and liquidation expenses	5,144,620
Total expenses	<u>18,788,920</u>

Share insurance fund, unadjusted net income accumulated since January 1, 1971	62,988,144
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Prior period adjustment due to change in accounting	<u>219,476</u>
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Share insurance fund, net income accumulated since January 1, 1971	<u>\$63,207,620</u>
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GAO's notes following this schedule are an integral part of the financial statement.

GAO's opinion on these statements appears on page 15.

GAO NOTES TO FINANCIAL STATEMENTS

SHARE INSURANCE FUND

1. Accounting policies

- U.S. Government securities are presented at amortized cost, which is the purchase price of the securities less the amortized premium or plus the amortized discount. Premiums and discounts are amortized on a straight-line basis from the acquisition date to the maturity date.
- The basis for costs allocated from the operating fund is the actual time spent on share insurance activities.
- Share insurance premiums are paid by insured credit unions on a calendar year basis and are applicable to 2 fiscal years. Accordingly, the Credit Union Administration defers one-half of the share insurance premiums received to the fiscal year following receipt of the premiums.
- The financial statements do not show an estimate of the liability which the Credit Union Administration could incur as a result of problem conditions existing in insured credit unions.

2. The Administrator is authorized by the Federal Credit Union Act (12 U.S.C. 1787(i)(1) (1970) and supp. V (1975)) to purchase the assets of insured credit unions which are closed for liquidation on account of bankruptcy or insolvency. In these cases where the Administrator is acting as the liquidating agent, the purchase of the assets may not be made without court approval.

3. Subsequent to June 30, 1975, the Credit Union Administration estimated that \$79,017 of the \$175,321 loans to insured credit unions may not be collectable and accordingly established an allowance for losses on this loan in fiscal year 1976.

4. The Administrator is required by the Federal Credit Union Act (12 U.S.C. 1787(a)(2) and (h) (1970) and supp. V (1975)) to notify each shareholder of a closed credit union so that the shareholder can claim his insured account. If after 18 months from the date of appointment of the liquidating agent for the closed credit union the shareholder fails to claim the insured account, the liability of the share insurance fund to pay the full

amount of the unclaimed shares to the shareholder ends. These statements do not include accountability for the funds held in trust for unpaid shareholders of liquidated credit unions. These funds, which amounted to \$848,561 and \$527,296 at June 30, 1976 and 1975, respectively, were held by the U.S. Treasury. Unclaimed shares in closed insured credit unions amounted to \$1,113,577 and \$1,169,135 at June 30, 1976 and 1975, respectively. Of the \$1,113,577 at June 30, 1976, \$365,633 had been held in excess of 18 months and will be deposited to the Treasury trust fund in the near future.

5. The liability of \$383,480 to other agencies arose from an agreement between the Credit Union Administration and the Office of Economic Opportunity which provided the Credit Union Administration funds to make selected Federal credit unions qualified for insurance. During fiscal years 1976 and 1975, \$43,738 and \$7,972, respectively, had been paid from the funds to liquidate OEO-related Federal credit unions included under the agreement.
6. The Administrator is authorized by the Federal Credit Union Act (12 U.S.C. 1788(a)(2) (1970) and supp. V (1975)) to guarantee loans of liquidating credit unions purchased by other organizations to expedite the distribution of assets of the liquidating credit unions. These guarantees create a contingent liability on the share insurance fund that is not included in these statements as follows:

June 30, 1976	\$5,284,206
June 30, 1975	\$2,550,295

During fiscal years 1976 and 1975, a number of the agreements expired and the Administrator repurchased the loans specified in the contracts. At June 30, 1976 and 1975, the Credit Union Administration was administering 1,663 and 2,280, respectively, of these loans totaling \$1,313,998 and \$1,129,708.



NATIONAL CREDIT UNION ADMINISTRATION
Washington, D. C. 20456

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MAR 25 1977

Office of the Administrator

Mr. Stewart D. McElyea
Director
Washington Regional Office
U.S. General Accounting Office
803 West Broad Street, Fifth Floor
Falls Church, VA 22046

Dear Mr. McElyea:

Reference is made to your letter of March 11, 1977, concerning the GAO draft report for fiscal years 1976 and 1975. The comments I am providing you address the major recommendations highlighted in your report.

Prior to addressing these areas, I wish to express my appreciation for the efforts of your staff. As in the past, your recommendations relating to our operations and accounting practices have proven to be very constructive and have assisted us in continuous strengthening of our policies and practices.

UNCOLLECTABLE LOANS

As suggested in your report, as of June 1976, NCUA has implemented a vigorous charge-off procedure for all loans considered to be uncollectable. In addition, we have expended considerable efforts in purifying "bad addresses" on the loans currently held by NCUA. I feel confident that your next audit will reflect a higher return on your verification of loan accounts.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

Our office is currently developing a policy to review the adequacy of the allowance account based on program experience. This will involve a periodic evaluation of the collectability of the loan portfolio. Now that we have worked with this program for three years we feel that our experience is sufficient enough to develop policy.

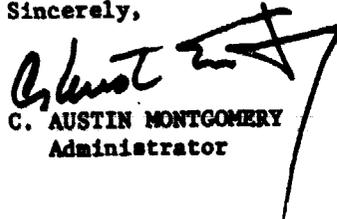


EXPANDED SCOPE OF INTERNAL AUDIT

Your recommendation to expand the scope of our internal audit function to all Washington office activities is being studied.

The above comments are requested for consideration for incorporation in your report to Congress. Should further information be desired, please feel free to contact the Assistant Administrator for Fiscal Affairs, Harvey J. Baine III.

Sincerely,


C. AUSTIN MONTGOMERY
Administrator

PRINCIPAL OFFICIALS OF THE
NATIONAL CREDIT UNION ADMINISTRATION
RESPONSIBLE FOR THE ACTIVITIES
DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
ADMINISTRATOR:		
C. Austin Montgomery	June 1976	Present
Herman Nickerson, Jr.	Sept. 1970	June 1976
DEPUTY ADMINISTRATOR:		
Lorena C. Matthews	July 1974	Present
ASSISTANT ADMINISTRATOR FOR ADMINISTRATION: (note a)		
Ray Motsenbocker	Oct. 1974	Apr. 1976
ASSISTANT ADMINISTRATOR FOR MANAGEMENT AND PLANNING:		
Paul Trylko	Sept. 1976	Present
Ray Motsenbocker	Apr. 1976	Sept. 1976
ASSISTANT ADMINISTRATOR FOR FISCAL AFFAIRS:		
Harvey J. Baine III	Apr. 1976	Present

a/In April 1976 the Office of Administration was reorganized into the Office of Management and Planning and the Office of Fiscal Affairs.