NATIONAL CREDIT UNION ADMINISTRATION
OFFICE OF INSPECTOR GENERAL

MATERIAL LOSS REVIEW
OF
EL PASO'S FEDERAL CREDIT UNION

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ACRONYMS AND ABBREVIATIONS

ACH	Automated Clearing House
AEP	Annual Examination Scheduling Program
AIRES	Automated Integrated Regulatory Examination System
AMAC	Asset Management Assistance Center
ARDO	Associate Regional Director for Operations
BSA	Bank Secrecy Act
Call Reports	NCUA 5300 Call Reports
CAMEL	[C]apital Adequacy, [A]sset Quality, [M]anagement, [E]arnings, and [L]iquidity/Asset-Liability Management.
CPA	Certified Public Accountant
Credit Union	El Paso's Federal Credit Union
DOR	Document of Resolution
DSA	Division of Special Actions
DSA Director	Director, Division of Special Actions
EIC	Examiner-in-Charge
EPFCU	El Paso's Federal Credit Union
FCU Act	Federal Credit Union Act
FOM	Field of Membership
FPR	Financial Performance Report
FRB	Federal Reserve Bank
LUA	Letter of Understanding and Agreement
MLR	Material Loss Review
NCUA	National Credit Union Administration
NCUSIF	National Credit Union Share Insurance Fund
OIG	Office of Inspector General
RD	Region IV Regional Director
RFE	Risk-Focused Examination
SE	Supervisory Examiner
Teacher's	El Paso Teacher's Federal Credit Union
WCC	Work Classification Code

EXECUTIVE SUMMARY

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) contracted with Moss Adams LLP (Moss Adams) to conduct a Material Loss Review (MLR) of El Paso's Federal Credit Union (EPFCU or the Credit Union), a federally insured credit union. We reviewed EPFCU to: (1) determine the cause(s) of the Credit Union's failure and the resulting multi-million dollar loss to the National Credit Union Share Insurance Fund (NCUSIF); (2) assess NCUA's supervision of the Credit Union; and (3) provide appropriate suggestions and/or recommendations to prevent future losses.

To achieve these objectives, we analyzed NCUA examination and supervision reports, as well as related correspondence. We interviewed NCUA officials and regional staff, and reviewed NCUA guidance, including regional policies and procedures, and NCUA 5300 Call Reports (Call Reports) and Financial Performance Reports (FPRs).

[redacted]

- Management Integrity
  Senior management employees ("management") displayed a lack of integrity and did not manage the Credit Union in the best interest of its members. Examiners discovered the following:

  - [redacted]
  - fee income that far exceeded peers;
  - [redacted]
  - [redacted]

- Operational Irregularities
  The Credit Union demonstrated circumstances, which we believe examiners did not identify as significant risks. For instance, as noted above, fee income as reported in the FPRs and in examiner working papers was significantly

above that of peers. In addition, Credit Union senior management displayed a lack of competence and training appropriate to their position.

- Internal Control and Record Keeping Deficiencies
  NCUA examiners and the external CPA firm routinely reported poor internal controls, record keeping errors, and a lack of segregation of duties in critical areas. Specific recurring issues related to errors in Call Reports, cash, and bank reconciliations were not identified by examiners as potential fraud risk indicators.

- Board Oversight and Governance Issues
  Interviewees noted that examiners relied on the Board of Directors and Supervisory Committee to establish segregation of duties. This is consistent with our review of working papers. However, working papers revealed that members of both groups were financially unsophisticated. Review of EPFCU's Board minutes showed that neither group provided direction to management or required follow-up on findings from examiners or the external CPA firm.

We concluded that these factors created an environment where [redacted]

We determined NCUA could have mitigated the loss to the NCUSIF had they been more aggressive in identifying issues with excessive fee income, addressing root issues with internal controls and record keeping at the Credit Union, and identified and followed up on potential fraud risk factors.

As a result of our review, we are making four observations and three recommendations to NCUA management related to identifying and responding to fraud risks, revising the Red Flag Questionnaire, and third party confirmation of cash account balances.

We appreciate the effort, assistance, and cooperation NCUA management and staff provided to us during this review.

BACKGROUND

The NCUA OIG contracted with Moss Adams to conduct a Material Loss Review (MLR) for EPFCU, as required by Section 216 of the Federal Credit Union Act (FCU Act), 12 U.S.C. 1790d(j). EPFCU was a federally chartered credit union located in El Paso, Texas. NCUA's Region IV provided supervision over the Credit Union.

<u>History of El Paso's Federal Credit Union</u>

NCUA chartered EPFCU in 1952 as El Paso Smelter Workers Federal Credit Union. It received a low-income designation in 1994 and changed its name to El Paso's Federal Credit Union in 2002. The field of membership consisted of employees of the American Smelting and Refining Company; employees who worked in or were paid from El Paso Disposal, West Silver Inc., and Interbrick, Inc.; as well as affinity groups (e.g. Credit Union employees and immediate family members).

Region IV supervised EPFCU and consistently rated the Credit Union a Composite CAMEL 2 until the September 30, 2011 (effective), examination.

An examiner, who was validating the September 2011 call reports for the District Examiner, noted irregularities in Undivided Earnings. The examiner brought this to the attention of the Supervisory Examiner (SE) who agreed to a second contact, September 30, 2011 (effective), to investigate the cause of the variance. The first contact the examiner performed had a June 30, 2011 (effective) date. The two contacts together constituted a full examination.

Analysis by examiners as part of the September 2011 (effective) contact, revealed a number of anomalies. [redacted] In addition, examiners noted a lack of records surrounding daily transactions with the FRB, variances between accrued dividends per the share certificate trial balance and the general ledger, excessive fees, [redacted] Examiners provided journal entries to the Credit Union to accrue dividends and reverse fee income. Examiners downgraded the CAMEL Composite rating from a 2 to a 4. Documents of Resolution (DOR) included hiring a third party to help correct accounting records, completing a 100 percent negative verification of member accounts, reconciling the FRB account daily, and reviewing all fees charged to member share accounts in 2010 and 2011 to determine amounts to be refunded to members for excessive fees. In addition, a Letter of Understanding (LUA) was prepared to address the following issues:

- Inadequate controls over the FRB account;
- Inaccurate posting to member accounts;
- Inadequate balance sheet management; and
- Inaccurate financial statements.

An e-mail from the Examiner-in-Charge (EIC) to the SE dated November 4, 2011, sent during the September 30, 2011 (effective) contact, and forwarded to the ARDO the same day, showed that the EIC and SE considered it appropriate to ask the EPFCU Board to suspend the Credit Union's manager. However, the SE and EIC decided to wait for the third party audit report before recommending this course of action. The manager remained in her position until September 2012, when the Board placed her on administrative leave in response to the examiner's documentation of questionable transactions.

The November 4, 2011 e-mail also documented that examiners discovered further irregularities related to member share accounts. [redacted] As shown later in the Results in Detail section of this report, this was not an isolated incident. Our analysis shows that throughout the scope period of this review, fee and other operating income per average total assets, averaged approximately 3.73 times the peer average, ranging from a minimum of 2.64 times peer average for the quarter ended March 31, 2006, to a maximum of 7.20 times peer average for the quarter ended March 31, 2011.

During the September 30, 2011 examination (effective), examiners discovered monthly checks written to American Express, some of which were not recorded in the OTC Transaction Report, and several of which were written against the member share accounts to which the suspicious fee income had been offset.

We learned that during the December 31, 2011 contact (effective), examiners decided not to deliver the LUA because they considered the Credit Union to have made progress in clearing the DORs from the September 2011 contact and felt the LUA did not address the suspicious issues directly. Examiners upgraded the Credit Union from a CAMEL Composite 4 to 3 at the end of this contact. In the examination working papers, the EIC indicated he needed to either draft a new LUA or upgrade the CAMEL Composite rating. He noted that since a Bank Secrecy Act (BSA) finding existed, the next contact could still occur within three months. He also

1 [redacted]

believed that the upgrade would help shift the Board's focus away from the CAMEL Composite rating and towards concerns with accounting irregularities.

For the next contact, January 31, 2012 (effective), we learned during interviews that regional officials made a decision to replace the EIC in order to have someone with a specialty in internal controls and experience with fraud lead the examination.[2]

[redacted]

Examiners issued a number of DORs, including a requirement for management to have the contracted CPA firm perform positive verification of specific accounts, i.e., those noted during the last contact as having addressed changes and unusual fee income transactions previously identified during the September 30, 2011 examination. At the end of the January 31, 2012 contact (effective), examiners downgraded the CAMEL Composite rating of the Credit Union from 3 to 4.

Subsequently, Region IV officials issued an LUA at the on-site supervision contact effective March 31, 2012. The EPFCU Board refused to sign this LUA. According to examination working papers, the Board felt they were making progress addressing the DORs and did not consider themselves a risk to the NCUSIF. Region IV officials decided to issue a Regional Director Letter. This letter, issued August 3, 2012, addressed the following items:

1. Inappropriate record keeping related to excessive and improper posting of fee refunds as dividends, a continued lack of written accounting procedures and a lack of support for reconciling items;

2. Failure to comply with National Automated Clearing House Association's requirement for an annual ACH audit; and

3. Continued operating losses.

[2] Interviewees informed us that at higher levels, examiners obtain training in a specialty. The EIC for the September 30, 2011 examination (effective), trained in specialized lending areas while the new EIC specialized in record keeping and internal controls. The SE made the decision to exchange the two examiners to use their skill sets more effectively.

The letter specified that failure to address these concerns could result in further deterioration and that examiners would return by August 13, 2012, to conduct an examination to include a review of progress on the identified items. The letter also left open the possibility of further administrative action if the Examiner's Report indicated the Credit Union had not appropriately addressed concerns.

The Examiner returned for the June 30, 2012, examination (effective), on August 13, 2012. The examination lasted 299 hours, more than the previous five contacts combined, and consisted of a team of four examiners. Examiners discovered a number of additional anomalies during this contact. For instance, they determined that the Credit Union failed to properly safeguard foreclosed assets, including allowing use of the asset by the former spouse of the previous owner. They also identified issues with the processing of cash deposits through teller drawers, loans made to related parties that showed signs of preferential treatment, and problems with the method for calculating the Allowance for Loan and Lease Loss. In addition, examiners found problems with the execution of loan collections and charge offs, the sufficiency of Board minutes, identification of delinquent loans, backdating of transactions, and the Credit Union's advertised field of membership.

Examiners reported difficulties obtaining the journal and cash record, noting that despite earlier requests, they did not receive the information until the very end of the examination. They also determined that the manager was able to access her own member account as well as those of her family members, and that the Board Chairman received questionable payments for Board meetings and expenses.

[redacted] Examiners presented these documents to the Board with a recommendation to place the Manager on administrative leave. The EPFCU Board followed examiner recommendations and placed the manager on paid administrative leave as of September 13, 2012.

The Board also agreed to hire contract staff from another local credit union to run the Credit Union and to hire a forensic examiner.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

The following day, the Region IV Regional Director (RD) recommended the Board place the assistant manager on administrative leave. [redacted]

[redacted] The director immediately contacted Region IV's ARDO to inform her that they would have to take the liquidation package to the NCUA Board.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[3] [redacted]

[redacted]

Our review of examination working papers document that the RD and DSA Director approached El Paso Teacher's Federal Credit Union (Teacher's) about a purchase and acquisition agreement. Consistent with later developments, the DSA Director noted that an agreement was reached allowing Teacher's to acquire certain shares and loans, and to operate for 90 days from the EPFCU building to provide time to determine whether they would acquire that as well.

On September 28, 2012, fifteen days after the Board placed EPFCU's manager on administrative leave and 46 days after examiners started fieldwork for the final full examination dated June 30, 2012 (effective), NCUA officials delivered the liquidation order to EPFCU's Chairman of the Board.

NCUA Examination Process

Total Analysis Process

NCUA uses a total analysis process that includes collecting, reviewing, and interpreting data; reaching conclusions; making recommendations; and developing action plans. The objectives of the total analysis process include evaluating CAMEL[4] components, and reviewing qualitative and quantitative measures. NCUA uses the CAMEL Rating System for evaluating the soundness of credit unions on a uniform basis, the degree of risk to the NCUSIF, and for identifying those institutions requiring special supervisory attention or concern. The CAMEL rating includes consideration of key ratios, supporting ratios, and trends. Generally, the examiner uses the key ratios to evaluate and appraise the credit union's overall financial condition. At the conclusion of an examination, examiners assign a CAMEL rating.

Examiner judgment affects the overall analytical process. An examiner's review of data includes structural analysis,[5] trend analysis,[6] reasonableness analysis,[7] variable data analysis,[8] and qualitative data analysis.[9] Numerous ratios measuring

[4] The acronym CAMEL derives its name from the following components: [C]apital Adequacy, [A]sset Quality, [M]anagement, [E]arnings, and [L]iquidity/Asset-Liability Management.
[5] Structural analysis includes the review of the component parts of a financial statement in relation to the complete financial statement.
[6] Trend analysis involves comparing the component parts of a structural ratio to itself over several periods.
[7] As needed, the examiner performs reasonableness tests to ensure the accuracy of financial performance ratios.
[8] Examiners can often analyze an examination area in many different ways. NCUA's total analysis process enables examiners to look beyond the "static" balance sheet figures to assess the financial condition, quality of service, and risk potential.

a variety of credit union functions provide the basis for analysis. Examiners must understand these ratios both individually and as a group because some individual ratios may not provide an accurate picture without a review of the related trends.

Financial indicators such as adverse trends, unusual growth patterns, or concentration activities can serve as triggers of changing risk and possible causes for future problems. The NCUA also instructs examiners to look behind the numbers to determine the significance of the supporting ratios and trends. Furthermore, the NCUA requires examiners to determine whether material negative trends exist, ascertain the action needed to reverse unfavorable trends, and formulate, with credit union management, recommendations and plans to ensure implementation of these actions.

Risk-Focused Examination Program

In 2002, the NCUA adopted a Risk-Focused Examination (RFE) Program. Risk-focused supervision procedures often include reviewing off-site monitoring tools and risk evaluation reports as well as on-site work. The RFE process includes reviewing seven categories of risk: *Credit, Interest Rate, Liquidity, Transaction, Compliance, Strategic,* and *Reputation*. Examination planning tasks may include: (a) reviewing the prior examination report to identify the credit union's highest risk areas and areas that require examiner follow-up; and (b) analyzing Call Reports as well as the risks detected in the credit union's operations and in management's demonstrated ability to manage those risks. A credit union's risk profile may change between examinations. Therefore, the supervision process encourages the examiner to identify those changes in profile through:

- Review of quarterly Financial Performance, Risk, and Call Reports;
- Communication with credit union staff; and
- Knowledge of current events affecting the credit union.

On November 20, 2008, the NCUA Board approved changes to the risk-based examination scheduling policy, creating the Annual Examination Scheduling Program (AEP).[10] NCUA indicated these changes were necessary due to adverse

[9] Qualitative data includes information and conditions that are not measurable in dollars and cents, percentages, numbers, etc., which have an important bearing on the Credit Union's current condition, and its future. Qualitative data analysis may include assessing lending policies and practices, internal controls, attitude and ability of the officials, risk measurement tools, risk management, and economic conditions.

[10] The AEP requires either an examination or a material on-site supervision contact within a 10 to 14 month timeframe based on risk-based scheduling availability. The minimum and maximum time between the completion dates of one examination to the completion date of the next examination is 8 months and 23 months, respectively.

economic conditions and distress in the nation's entire financial structure, which placed credit unions at greater risk of loss. The NCUA stated that the Annual Program would provide more timely relevant qualitative and quantitative data to recognize any sudden turn in a credit union's performance.

OBJECTIVES, SCOPE, AND METHODOLOGY

We performed this material loss review to satisfy the requirements of Section 216(j) of the FCU Act, 12 U.S.C. §1790d(j), which requires the OIG to conduct a material loss review when the NCUSIF has incurred a material loss.[11]

The objectives of the MLR were to:

1. Determine the cause(s) of the Credit Union's failure and the resulting loss to the NCUSIF;

2. Assess the NCUA's supervision of the institution, including implementation of the Prompt Corrective Action requirements of Section 208 of the FCU Act; and

3. Make appropriate observations and/or recommendations to prevent future losses.

To accomplish our review, we performed fieldwork at the NCUA's Region IV office in Austin, Texas. The scope of this review covered the period from January 2006 through liquidation in September 2012.

To determine the cause(s) of EPFCU's failure and assess the adequacy of NCUA's supervision, we:

- Completed the Risk Assessment, which included a review of the Examination Overviews as well as other risk considerations, including consideration of minimum scope requirements for examiners.

- Prepared a chronology and summary table of regulatory examinations, which include exam date, regulator, CAMEL rating, supervisory actions, and significant examiner comments.

[11] The FCU Act deems a loss "material" if the loss exceeds the sum of $25 million or an amount equal to 10 percent of the total assets of the credit union at the time in which the NCUA Board initiated assistance under Section 208 or was appointed liquidating agent.

- Reviewed exam files, including exam reports, risk assessments, examination findings, DORs, confidential sections, corrective actions, exam spreadsheet files, correspondence, analysis, and supplementary documentation.

- Reviewed EPFCU's Board of Directors minutes and Board packets, as well as Supervisory Committee minutes provided.

- Reviewed the external reports on agreed-upon procedures and member account verification, including results, findings, and responses, as provided.

- Conducted interviews with Region IV and AMAC officials involved with the examination, supervision, and/or liquidation of EPFCU.

- Downloaded Call Reports for the scope period and performed analysis of a number of financial indicators, including net interest margin, nonmember shares, fee income, interest income, compensation, and other elements of the balance sheet and income statement.

- [redacted]

- Developed a timeline and summary of enforcement actions taken by the NCUA from 2006 through liquidation.

- Assessed NCUA supervision and evaluated the timeliness of supervisory actions, including examiner comments and findings, as well as communication and follow up procedures.

- Assessed the effectiveness of EPFCU management, and oversight by the Supervisory Committee and Board of Directors.

We relied upon the materials provided by the NCUA OIG and Region IV officials, including information and other data collected during interviews.

We used computer-processed data from NCUA's AIRES and NCUA online systems. We did not test controls over these systems; however, we relied on our analysis of information from management reports, correspondence files, and interviews to corroborate data obtained from these systems to support our audit conclusions.

We conducted this review from February 2013 through August 2013, 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 objective. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The scope of this audit included an analysis of EPFCU from January 2006 to September 2012, the date of liquidation. Our review also included an assessment of NCUA regulatory supervision during the same period.

RESULTS IN DETAIL

We determined that EPFCU failed [redacted] Contributing factors included issues with management integrity, operational irregularities, internal controls and record keeping, as well as the effectiveness of those charged with governance (the Board of Directors and Supervisory Committee). These issues created an environment in which the omission of these share certificates from the books of the Credit Union could go undetected.

A. Why El Paso's Federal Credit Union Failed

Management's Actions Caused EPFCU to Fail

The underlying cause of EPFCU's demise [redacted] Highlighted below are the specific factors we believe contributed to the ultimate cause of EPFCU's failure.

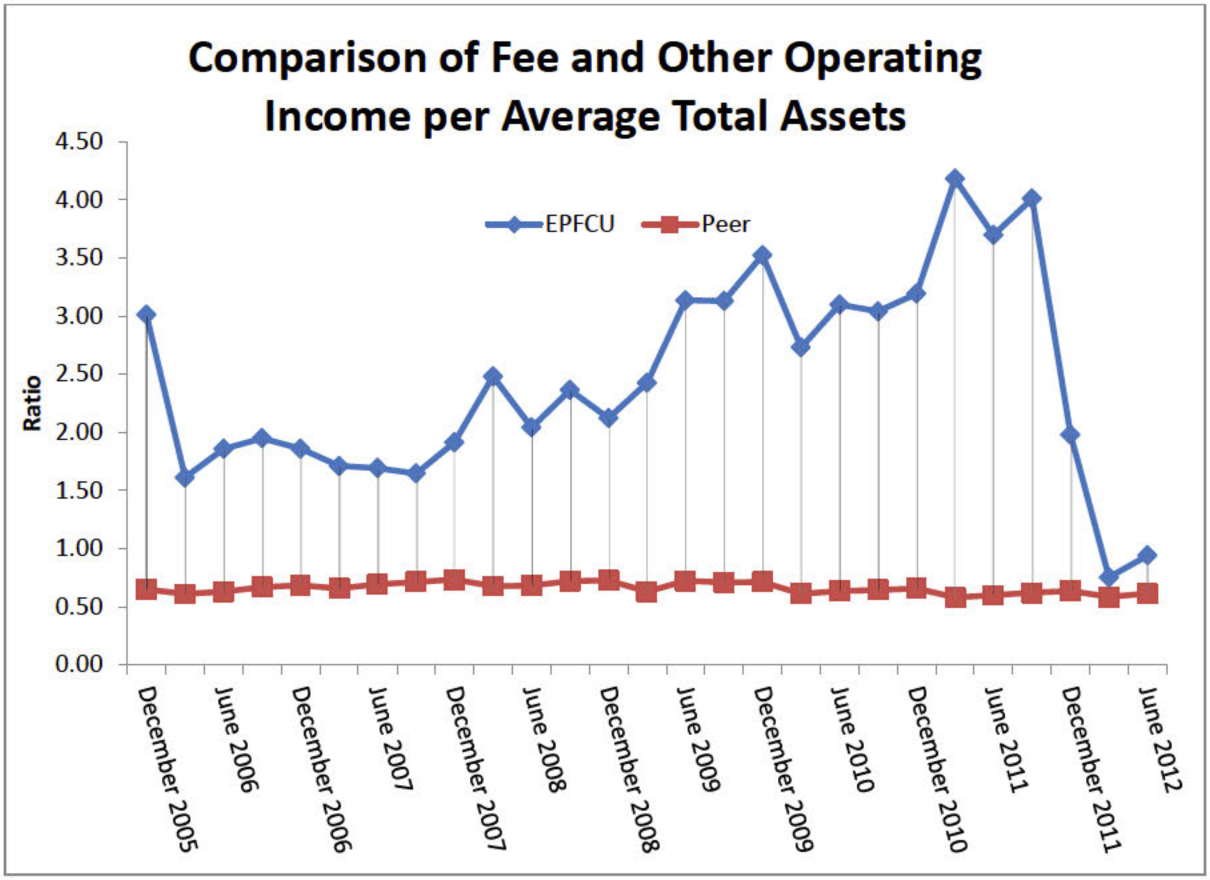
Management Integrity Lacking

Our review of available evidence indicates that EPFCU management did not operate the Credit Union in a manner consistent with the best interests of its members. In brief, fee income was outside of expectations based on peer results, and there were persistent issues with record keeping and reconciliation of key cash accounts. [redacted]

[redacted] We analyzed fee and other noninterest income as a function of average assets over the period under scope using data reported in the quarterly Financial Performance Reports (FPR) (Table 1). We noted that this ratio significantly exceeded peers throughout the period under scope, averaging nearly four times that of peers.

12 [redacted]

Table 1



[redacted]

Our review of examination working papers from the final full examination of EPFCU indicated that the Credit Union held two assets obtained through foreclosure. One of these assets, a boat, was located at an auto storage lot, away from the street, with no sign or other indication to note it was for sale. When the examiner attempted to locate the other asset, a luxury vehicle, management successively told her it was in one place and then another, including a garage owned by the daughter of a member of the Board. This pattern repeated a number of times over a series of days [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Based on our review of the aforementioned issues, we believe management lacked integrity, which contributed to the ultimate demise of EPFCU.

Operational Irregularities Present

Our review of examination working papers identified a number of circumstances we believe are inconsistent with the expected operations of the Credit Union. Specifically, we noted the presence of excessive fee income, nonmember share certificates, and other irregularities.

Per our review of examination working papers, examiners first identified fees as a concern during the September 30, 2011 examination (effective). [redacted]

In addition to the irregularity in noninterest income, which points to inappropriate use of the fee income, our review of examiner working papers identified a number of other irregularities. For example, examiners noted that the Credit Union's website listed EPFCU's field of membership (FOM) as open to all El Paso and Las Cruces area residents. Consistent with this, examiners also reported the manager asserted the Credit Union's FOM extended out in a 25-mile radius. However, examiners noted the Credit Union based its field of membership on employment history, which we found consistent with review of the charter. In addition, examiner working papers revealed that neither the manager nor the assistant manager held sufficient skills to perform their duties. Through interviews and examination working papers, we learned that both the assistant manager and manager took classes in bookkeeping at the local community college under the recommendation of NCUA examiners. When NCUA involuntarily liquidated EPFCU, these individuals had not yet completed their classes.

In the June 30, 2012 examination (effective), examiners identified access control issues noting that the manager had access to her own account as well as the accounts of family members. [redacted]

Although these irregularities do not rise to the same significance as the issues noted with fee income, their presence documents a poorly run credit union where lack of competence, or the appearance thereof, created an environment in which fraud was difficult to separate from error.

Internal Control and Record Keeping Deficiencies Noted

NCUA examiners and EPFCU's external CPA firm routinely reported poor internal controls, record keeping errors, and a lack of segregation of duties in critical areas. Later examinations also revealed issues with teller cash drawer reconciliations, as well as the unusual entries to fee income described above.

Review of examiner working papers routinely documented corrections to the Call Reports, which we found to be consistent with responses from interviewees. Other issues with record keeping included findings by examiners and the external CPA firm that the share sub ledger did not match the general ledger, as well as issues with FRB account reconciliations. In the December 31, 2011 contact (effective), examiners noted that some cash deposits were conducted in an unusual manner.

[redacted]

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13 [redacted]

[redacted]

Examiners and external auditors often cited segregation of duties issues, particularly in the areas of wires, disbursements, loan processing, and bank reconciliations. [redacted]

Board Oversight and Governance Issues

During interviews, we learned that EPFCU's internal control environment relied on oversight by the Supervisory Committee and the Board of Directors to ensure compliance; however, based on the following issues that highlight the Supervisory Committee and Board of Directors efforts, we determined their oversight to be ineffective.

Management and those charged with governance (Supervisory Committee and Board of Directors), appear to have had a relationship that potentially hindered objective oversight. We learned during interviews that there was little turnover in either the Board of Directors or the Supervisory Committee, with members in place for decades. Likewise, examination working papers documented that both the manager and assistant manager had been with the Credit Union since the 1980s. During the June 30, 2012 examination, examiners noted the Chairman of the Board and management spent considerable time together and interacted socially. This is consistent with other findings identified by examiners, which we believe led to an environment where those charged with governance were too close to management to oversee them effectively.

In addition, we generally found the minutes from Board of Directors and the Supervisory Committee meetings to be inaccurate and incomplete, consistent with external audit findings. The minutes did not reflect consistent monitoring or approval of policies, rates and charge offs, nor attention to financial information and key performance indicators. We found no evidence that any of the Board members had a financial background, nor asked questions related to financial reporting.

We also performed a comparison of the Treasurer's report on a month-to-month basis. This review documented inconsistencies such as the same balances reported for cash and share accounts, illogical member counts, and significant swings in cash, share balances, and loans. The minutes reflected no evidence of related Board discussion or explanation. Similarly, examiners repeated findings over timeliness of BSA audits; however, there is no documentation to suggest the Board considered this an issue. Since Board minutes included no documentation of discussion, follow up or oversight in remediating auditor and examiner findings, actions taken, if any, remain unclear.

Likewise, as documented elsewhere in the review, examination findings and DORs, as well as findings from the external CPA firm, were prevalent. However, no evidence exists to suggest that the Board held discussions with the manager to either hold her accountable for accounting discrepancies in the Treasurer's reports, consistent errors in the call reports, recurrent findings by examiners and external CPAs, or to resolve the identified deficiencies.

As was the case for examiner and external CPA firm findings and DORs, our review of the minutes revealed no discussion of [redacted]

[redacted]

B. NCUA's Supervision of El Paso's Federal Credit Union

NCUA Could Have Mitigated the Loss to the NCUSIF

We determined examiners missed several warning signs that we believe should have triggered further examination procedures designed to identify suspicious activity. [redacted]

In particular, fee income, in which examiners were able to show in later examinations to have been involved in suspicious transactions, showed results far exceeding those of peers. In addition, examiners did not properly identify fraud risk factors as documented in the Red Flag Questionnaire section of NCUA's "Question" working paper, or the Risk Assessment working papers.[14]

Supervisory Background

EPFCU received a CAMEL Composite rating of 2 at the conclusion of the June 30, 2010 examination (effective), an indication of strong performance. An examiner assisting the District Examiner in validating the September 30, 2011 call reports noted issues with undivided earnings, and the Supervising Examiner determined a second contact with an examination effective date of September 30, 2011 was necessary.[15] At the end of this contact, the CAMEL Composite was downgraded to 4. The next contact, December 31, 2011 (effective), upgraded the CAMEL Composite to 3. Our review of examination working papers indicated that examiners still had considerable concerns about EPFCU but felt that since they had justification to complete contacts on a quarterly basis and that an upgrade in the rating would gain better cooperation from the Board, this upgrade was appropriate.[16] The CAMEL Composite was again downgraded to 4 at the next contact, January 31, 2012 (effective), where it remained until the final full examination, June 30, 2012 (effective), when it was downgraded to 5.

[14] Use of the Red Flag Questionnaire resulted from the NCUA's update of minimum scope requirements for examiners through issue of Instruction 5000.20, rev. 1 (effective January 1, 2011). [redacted] Use of this questionnaire was not required for examinations prior to June 2010, including several in our scope. [redacted]

Together, the June 30 and September 30, 2011 examinations (effective) constituted a single full examination, or Work Classification code (WCC) Type 10, which NCUA defines as a regular examination or insurance review of a federally chartered credit union.

[16] Review of correspondence between the Supervisory Examiner and the ARDO indicated the ARDO strongly disagreed with this decision. We provide additional details regarding the upgraded rating in the Background section of this report.

NCUA Region IV provided EPFCU with an Involuntary Notice of Liquidation and Revocation of Charter at the end of this contact.[17] Table 2 (below) provides Composite and specific CAMEL ratings for the applicable examinations during the scope period of our review.

Table 2

NCUA Examination Results for EPFCU**							
Examination Effective Date	Type[18]	CAMEL NCUA Composite	Capital / Net Worth	Asset Quality	Management	Earnings	Liquidity
June 2012	27	5	5	4	5	5	4
June 2012	10	5	5	4	5	5	4
March 2012	22	4	2	3	4	4	2
January 2012	22	4	2	3	4	4	2
December 2011	22	3	2	3	3	4	2
September 2011	10	4	2	3	4	4	2
June 2011	10	2	1	3	2	2	1
June 2010	10	2	1	2	2	2	2
March 2009	22	2	1	3	2	2	2
June 2008	10	2	1	3	2	2	2
June 2007	10	2	1	3	2	1	2
March 2007	22	2	1	3	2	1	2
June 2006	10	2	1	3	2	1	2

***Examination information provided by NCUA's Region IV.*

Failure to Identify Risks Related to Management

Although NCUA examiners did identify some risk factors related to management integrity, they did not identify excessive fee and other operating income as a function of average total assets to be an indication of inappropriate transactions, nor did they identify other irregularities as fraud risk factors.

[17] On September 26, 2012, the NCUA Region IV Director requested authority from the NCUA Board to liquidate EPFCU involuntarily. NCUA General Counsel concurred with Region IV's request for liquidation on September 26, 2012, and the E&I concurred on September 27, 2012. The NCUA Board approved the request September 27, 2012. The NCUA Region IV Director presented the Order to the Chairman of the Board on September 28, 2012.
[18] As previously noted, WCC Type 10 is a regular examination or insurance review of a federally chartered credit union. Type 22 is an on-site supervision contact of a federally chartered credit union, and a Type 27 is an off-site supervision contact of a federally chartered credit union.

As documented in Section A. above, using FPR data we analyzed fee and other noninterest income as a function of average total assets and noted it to be significantly higher than peer average. We performed this same analysis using the data directly from the Key Ratio section of the working papers. Results of our analysis are analogous to those documented in Table 1 and show that examiners reviewed working papers documenting excessive fee income. However, we noted no indication until the September 30, 2011 examination (effective), that examiners recognized this as an indicator of an issue.

We analyzed the Red Flag Questionnaire (following implementation of Instruction 5000.20, rev. 1) and the Transaction Risk sections of the Preliminary and Final Risk Assessment working papers to determine if these documents identified red flags we would expect to see identified based upon our understanding of the Credit Union's operations.

During our review of examination working papers, we noted a marked shift in the tone of examiners' assessment of management starting with the September 30, 2011 examination (effective). For instance, the Examination Overview for the June 30, 2011 examination (effective) stated the following:

> *[I] thoroughly enjoyed working with the staff of the credit union. You all were most accommodating during the examination, professional and helpful in any way.*

Three months later,[19] during the September 30, 2011 examination (effective), working papers cite management as feeling "picked on." As a result, management asked a retired NCUA examiner who had conducted many of the prior examinations to join the Board. [redacted] In addition, we did not see management style documented in the Transaction Risk section of the Preliminary or Final Risk Assessments of any of the examinations under scope.

[redacted]

[19] The June 30, 2011 examination took place from August 1 to 11, 2011, while the September 30, 2011, examination took place from November 1 – 17, 2011.

[redacted]

[redacted]

Results of our review of examiner working papers and interviews also noted that the Credit Union had no documented fraud policy. This is a specific field on the Red Flag Questionnaire and our review of Questionnaires provided by Region IV determined mixed identification of this as an area of risk. For example, examiners identified it as a risk in the June 30, 2010 examination (effective), but not during the June 30, 2011 examination (effective). Examiners identified it again during the June 30, 2012 examinations (effective). Different EICs completed each of these examinations; therefore, we believe training is the most likely explanation for the inconsistent treatment. Regardless, we noted no evidence of an examiner finding or a DOR that would have required EPFCU management to prepare a fraud policy for approval by the Board.

NCUA Instruction 5000.20, rev. 1, issued December 28, 2010, specifies:

> *[T]ransaction risk is a growing risk due to a higher degree of fraudulent activities and a continuing lack of adequate due diligence over products and services. Recent NCUSIF losses highlight the significance of transaction risk.*

This instruction implemented the use of the Red Flag Questionnaire as a response to concerns over transaction risk. The Questionnaire provides several fields intended to focus examiners on the areas of account reconciliations, management, and other indicators of potential fraud. We learned during interviews that examiners were not aware of these factors until conducting more in-depth examinations in 2012.

Results of interviews indicated a lack of specific training for examiners in detecting fraud or identifying weaknesses in antifraud controls.[20] Likewise, interviews revealed no minimum procedures specified to identify risks of fraud or set mechanism to respond to suspicions of fraud. We also learned during interviews that examiners believe there are challenges when following up on fraud risk factors once identified due to scheduling issues.

Failure to Identify Risks Related to Unusual Transactions

Operations of the Credit Union included several unusual transactions; however, our review of examination working papers indicated examiners failed to identify some of the unusual transactions until near the end of the Credit Union's life.

As documented above, examiners failed to note or question excessive fee income. Other unusual transactions also did not appear to raise alarm. For example, nonmember shares appeared on the December 2009 Call Report, with $942 thousand reported as having a maturity of 1–3 years. Nonmember shares appear again on the June 2011, Call Report. However, the Call Reports document no nonmember shares in the interim. Examiners did not detect the faulty reporting of these shares until the January 2012 contact (effective). Likewise, the fact that no clear business purpose existed for these shares did not raise an issue until this contact.

The Red Flag Questionnaire does not provide for items such as management sophistication, improper weighting of management skill (i.e. managers that are very sophisticated surrounded by supporting staff that are not sophisticated), or level of sophistication for those charged with governance. Likewise, there is no place to document miscellaneous comments, such as management that either is misrepresenting their field of membership or is incompetent to the point of misunderstanding it. Had such fields existed, we believe examiners may have recognized risks present at the Credit Union at an earlier stage.

[20] NCUA OIG Report #OIG-12-08, "Review of NCUA's Red Flag Reports," examined a sample of 25 credit unions (five each from each NCUA region) where reviews of Call Reports indicated potential high-risk areas. The report concluded that examiners addressed high-risk areas for 19 of the 25 (76 percent) of the sampled credit unions. The report ultimately concluded that examiners appropriately completed Red Flag Questionnaires. However, this report does not negate those findings as this report focuses on qualitative indicators of fraud (e.g., management style, senior management lifestyle) rather than the quantitative factors that were the focus of the other report.

Failure to Identify Risks Related to Internal Control

By definition, internal controls are those activities, which, when properly designed and implemented, prevent and/or detect misstatement whether due to fraud or error. The following discussion details areas in which examiners did not identify red flags associated with internal controls.

During the June 30, 2012 examination (effective), examiners noted that the manager had access to her own accounts as well as those of her family. External CPA reports documented that the manager had access to override at least certain control areas. However, we found no documentation prior to the final full examination that indicated examiners considered this to be a red flag, despite being a specific question on the Red Flag Questionnaire.

Throughout the scope under review, examiners and the external CPA noted issues with record keeping. Likewise, corrections to the Call Reports were common. In most instances, examiners issued a DOR for the item which management cleared by the next examination. However, these issues generally recurred in subsequent examinations indicating the root issue was never resolved.

Likewise, procedures performed by the external CPA firm repeatedly found deficiencies in many areas, including bank reconciliations,[21] loan interest accrual, rate errors, share accounts (including sub ledgers out of balance), investment interest, general calculations, repossessed vehicles, and Board minutes. Our review of examiner working papers did not indicate that examiners considered results of issues identified by the CPA firm as significant in their risk assessments and exam procedures.

Despite numerous and recurring record keeping issues identified by both examiners and the external CPA firm, Region IV officials did not implement a more serious enforcement action than a DOR, despite the ability to do so.[22]

In addition, our review of examiner working papers show no documentation of the issues surrounding teller reconciliations in the Red Flag Questionnaire until the June 30, 2012 examination (effective), despite the fact that irregularities in teller

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[21] The minimum examination scope requirements mandated by NCUA Instruction 5000.20, rev. 1, specify that NCUA examiners are to test bank reconciliations including agreeing the reconciliation to the underlying data. However, results of interviews indicate that the current policy is to consider the statement provided by the credit union as sufficient supporting documentation instead of obtaining a third party confirmation. [redacted]

NCUA Rules and Regulations Part 715.12, allows the NCUA Board to require that a credit union obtain a full audit if it believes that serious and persistent record keeping deficiencies exist. Our review of working papers revealed no requirement by NCUA for a full audit or a request for a full audit by the Board.

reconciliations are a specific area of the Questionnaire. We believe that either examiners had not performed sufficient work to identify these issues or they did not consider them a high-risk area.

Overall, we believe these findings indicate that until the June 30, 2011 examination (effective), examiners did not consider EPFCU's poor internal control environment to be a significant fraud risk area despite numerous and repeated findings by both NCUA examiners and the external CPA firm.

Failure to Identify Risks Related to Board Oversight and Governance

We learned during interviews that segregation of duties at small credit unions is challenging and that examiners often rely on procedures performed by the Supervisory Committee and Board of Directors as internal controls. During our review of examination working papers, primarily the Examination Overviews, we found that this was the case at EPFCU. However, these examination working papers were silent regarding examiners' attempt to document problems with relying on the Supervisory Committee and the Board as internal controls or that other issues related to these institutions constituted a fraud risk.

We also learned during interviews that management and the Board had a relationship that was very close due to the duration of their relationship (since the 1980s). In addition, during the September 30, 2011 examination (effective), an individual who had been an examiner of the Credit Union for several years prior to his retirement became a member of the Board. However, we found no evidence in the working papers, outside of the June 2012 examination, to document this very tight relationship. Likewise, the Red Flag Questionnaire makes no mention that the relationship between management and those charged with governance as a potential risk factor.

Finally, our review of EPFCU's Board minutes showed that the Treasurer's reports did not match the Board packets. The minutes also revealed that the Board and Supervisory Committee failed to discuss important issues, including findings identified by examiners and the external CPA firm, direction by the Board to management, or nonmember shares. Examiners appear to have reviewed the minutes as recommended by the NCUA *Examiner's Guide,* which notes the following:

> *[M]inutes of board and committee meetings are a primary source of information by which examiners evaluate a board and its actions.*

However, our review of the examiner working papers revealed examiners did not document any of these missing discussion items as significant risk factors, e.g., by escalating the issues beyond an examiner finding.

OBSERVATIONS AND RECOMMENDATIONS

Once examiners detected the suspicious activity, Region IV supervisors and officials responded aggressively. Examination frequency and total contact hours increased starting in 2011 with an approximate two-fold increase from 2010 to 2011 and an approximate three-fold increase from 2011 to 2012. Additionally, the Region IV RD issued a memo to field staff in October 2012 specifying steps to detect fraud more quickly and formed a fraud project team to focus on fraud detection and investigation procedures. These actions are complementary with observations and recommendations listed below.

A. Observations

Important observations from the failure of EPFCU include:

- Results of examinations showed consistent and recurrent issues with accounting and record keeping. Management would clear findings only to have them recur in subsequent examinations indicating that the root of the problem continued to persist. Examiners should attempt to identify root issues and not clear findings or DOR items until management has corrected issues in a manner that provides lasting results.

- Segregation of duties is difficult for management to achieve at small credit unions, and often examiners must rely on the Board of Directors and Supervisory Committee as internal controls. We determined that those charged with governance at EPFCU were ineffective in providing oversight. NCUA final rule 701.4, effective July 21, 2011,[23] clarifies the duties of directors and provides a minimum timeframe for which directors must gain appropriate familiarity with basic finance and accounting practice. Final rule 701.4 came into effect near the end of EPFCU's existence and therefore we could not evaluate its effect on EPFCU. We believe NCUA management should monitor the effectiveness of NCUA final rule 701.4 to determine whether the rule is increasing the financial sophistication of directors. This is paramount at small credit unions where the Board and Supervisory Committee often serve as a vital internal control.

[23] NCUA final rule 701.4, "General Authorities and Duties of Federal Credit Union Directors," effective July 27, 2011, was communicated to Federal credit unions in *NCUA Letter to Federal Credit Unions*, Number 11-FCU-02, dated February 2011. Per the final rule, "At the time of election or appointment, or within a reasonable time thereafter, not to exceed six months, have at least a working familiarity with basic finance and accounting practices, including the ability to read and understand the Federal credit union's balance sheet and income statement and to ask, as appropriate, substantive questions of management and the internal and external auditors."

- Examiners relied on the external CPA to act as an important internal control; however, the CPA firm noted a considerable number of issues with each report on procedures performed. NCUA Rules and Regulations provide that examiners can require a full opinion audit of a credit union when serious and persistent record keeping deficiencies exist. We believe an opinion audit would have resulted in more detailed work than those performed as part of the agreed-upon procedures employed during the period under scope. Under an opinion audit engagement, the external CPA would have performed techniques such as analytical procedures over expense and fee income accounts, tests of internal controls, and third party confirmation of material accounts or equivalent procedures. In addition, the external CPA firm would have employed certain procedures designed to detect fraud.[24] While it is impossible to conclude that an opinion audit would have detected the inappropriate activity that resulted in the failure of EPFCU, we believe that had examiners exercised their option to require EPFCU to obtain a full opinion audit, it would have increased the probability of detecting improper transactions.

- During the final year of the Credit Union's life, an NCUA examiner who had recently retired and formerly served as the EIC for EPFCU joined the Supervisory Committee. Several interviewees mentioned that having the former examiner on the Supervisory Committee was an asset as he had valuable experience and acted as a knowledgeable liaison between the NCUA and EPFCU. We found no evidence linking the retired examiner to the failure of EPFCU, and determined his appointment complied with the 12-month waiting period required by Part 796[25] of the NCUA Rules and Regulations for federally insured credit unions. However, given that the failure of the Credit Union related to suspicious activity that may have been occurring while the examiner was the EIC assigned to EPFCU, to an outside observer, the appointment of the examiner to the Supervisory Committee presents the appearance of a possible conflict of interest. We suggest the NCUA remain aware of the potential risk to the integrity of NCUA's supervisory program in having former NCUA employees join the Supervisory

[24] Under AU Section 316 of the AICPA Professional Standards, *Consideration of Fraud in a Financial Statement Audit*, requires that the audit team perform certain procedures as part of an opinion audit, such as holding a discussion among engagement personnel regarding the risk of material misstatement due to fraud, inquiring of management and others within the entity about the risks of fraud, considering results of analytical procedures, considering fraud risk factors, and considering certain other information. AU Section 316 also specifies that, among other tests, auditors should design procedures to test the appropriateness of journal entries recorded to the general ledger, and gain an understanding of the rationale for transactions outside the normal course of business of the entity or the industry, and whether that rationale (or lack thereof) suggests that the transactions may have been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets.
[25] 12 U.S.C. 1786(w).

Committee or Board of Directors of any credit union in which they have previously examined.

B. Recommendations

Based on our review, we are making the following three recommendations.

We recommend NCUA management:

1. Implement a more comprehensive strategy for identifying and responding to fraud risk triggers. Areas to address include:

    a. Implementing training programs to educate examiners on identifying fraud risk factors and understanding controls to prevent and detect fraud.

    b. Developing specific examination procedures to identify fraud risk factors. At a minimum, NCUA management should identify procedures examiners should take when a lack of segregation of duties exists, for example, ensuring examiners conduct interviews with staff, management, and representatives of the Board of Directors and Supervisory Committee.

    c. Building resources to respond to fraud risk factors efficiently. We agree with suggestions provided by Region IV management, to include developing fraud teams at the national or regional level, identifying a list of vendors approved to perform such procedures on an as-needed basis, requiring credit unions themselves to have forensic procedures performed when deemed appropriate, or an appropriate combination of these responses.

Management Response

Management agreed with the recommendation. Management currently has several training programs available to address fraud recognition and detection and plans to require all examiners complete recordkeeping training through the NCUA LearnCenter over the next twelve months; will encourage all regions to discuss recent fraud cases and include fraud detection training as part of their multi-group meeting topics on a regular basis; and is working with the regional offices to finalize the Small Credit Union Exam Program, which will include fraud detection scope procedures. In addition, management indicated they are working with Region IV to develop a fraud questionnaire. Finally, management is building resources to respond to fraud risk factors by planning to develop and maintain a list of Certified Fraud Examiners within NCUA's staff as well as a vendor resource list of those able to assist with forensic procedures. Management's entire response is provided in Appendix A.

OIG Response

We concur with management's actions taken and planned.

2. Revise the Red Flag Questionnaire to capture emerging trends in credit union fraud as well as those that persist in the industry. Areas to consider include:

    a. Expanding the Red Flag Questionnaire to include a drill-down approach to fraud risk, with common risk areas leading to more specific risks.

    b. Developing specific examination procedures to respond to identified fraud risks in order to provide examiners with appropriate tools and techniques.

Management Response

Management agreed with the premise of the recommendation; however, management did not agree with the OIG's recommended method to use the Red Flag Questionnaire as the primary tool. Instead, as previously mentioned in Recommendation 1 above, management plans to develop a separate questionnaire that will provide examination procedures for use when fraud is suspected. In addition, management is finalizing the aforementioned Small Credit Union Exam Program, which will include fraud detection scope procedures that can be used during any examination when fraud is suspected or risks are present.

OIG Response

We concur with management's planned actions.

3. Current procedures allow examiners to rely on bank statements provided by Credit Union personnel as primary evidence for account balances. Given the importance of this information and its susceptibility to fraud, particularly in cases where internal controls are weak, certain account balances should be independently verified. Therefore, we recommend NCUA management:

    Update policies and procedures to require third party confirmations be obtained regularly for all accounts where the balance or activity is significant to the operations of the credit union. In addition, NCUA management should require this as part of agreed-upon-procedures conducted by external CPA firms.

Management Response

Management agreed with the recommendation and plans to include a step in the fraud detection scope of the Small Credit Union Exam Program related to third-party confirmations. In addition, during the next revision of the Supervisory Committee Guide, management plans to add guidelines requiring third-party confirmations as part of the non-opinion annual supervisory committee audit.

OIG Response

We concur with management's planned actions.

APPENDIX A: NCUA Management Comments

National Credit Union Administration

E&I/RMB:RMB/JMK
SSIC 1920

SENT BY E-MAIL

TO: Inspector General Jim Hagen

FROM: Executive Director Mark Treichel

SUBJ: Comments on Material Loss Review of El Paso Federal Credit Union #07823

DATE: August 23, 2013

This memorandum responds to your request for official comments on the Office of Inspector General's (OIG) report titled Material Loss Review (MLR) of El Paso Federal Credit Union #07823.

The MLR includes three recommendations which are outlined below with our specific response.

1. *Implement a more comprehensive strategy for identifying and responding to fraud risk triggers. Areas to address include:*

    a. *Implementing training programs to educate examiners on identifying fraud risk factors and understanding controls to prevent and detect fraud.*

    b. *Developing specific examination procedures to identify fraud risk factors. At a minimum, NCUA management should identify procedures examiners should take when a lack of segregation of duties exists, for example, ensuring examiners conduct interviews with staff, management, and representatives of the Board of Directors and Supervisory Committee.*

    c. *Building resources to respond to fraud risk factors efficiently. We agree with suggestions provided by Region IV management, to include developing fraud teams at the national or regional level, identifying a list of vendors approved to perform such procedures on an as-needed basis, requiring credit unions themselves to have forensic procedures performed when deemed appropriate, or an appropriate combination of these responses.*

Management Response: We agree with the recommendation.

NCUA currently has several training programs available to address fraud recognition and detection. New examiners are required to take a core class on Fraud Detection, which identifies the examiner's role in preventing and detecting fraud including the evaluation of internal controls. The NCUA LearnCenter also has training available on recordkeeping review. The session addresses red flags and fraud detection. Finally, we encourage all regions to discuss recent fraud cases and include fraud detection training as part of their multi-group meeting topics on a regular basis. ***We will require all examiners complete the LearnCenter training session over the next twelve months.***

The Examiners' Guide is clear on the purpose of the examination, which states, "The examination process, while not designed to detect fraud, may warrant expanded procedures when red flags exist."[1] As such, we do not believe all examinations should include fraud detection procedures, but those that warrant a review will have new examination procedures in place. The Office of Examination and Insurance (E&I) is currently working with the Regions to finalize the Small Credit Union Exam Program which includes fraud detection scope procedures. [redacted] In addition, Region IV is working with E&I to develop a fraud questionnaire that can be used to assist examiners when they suspect or identify fraud during an examination.

We will build resources to respond to fraud risk factors efficiently and plan to coordinate this nationally. NCUA currently has a cadre of recordkeeping and internal control subject matter examiners who are the first responders to this type of need. In addition, there is a cadre of Certified Fraud Examiners throughout the regions. As well, many regions have developed outside sources and vendors who are available to assist with fraud detection and forensic accounting. ***E&I will take steps to maintain a list of the Certified Fraud Examiners within NCUA's staff and develop a vendor resource list of those able to assist with forensic procedures.***

2. *Revise the Red Flag Questionnaire to capture emerging trends in credit union fraud as well as those that persist in the industry. Areas to consider include:*

    a. *Expanding the Red Flag Questionnaire to include a drill-down approach to fraud risk, with common risk areas leading to more specific risks.*

    b. *Developing specific examination procedures to respond to identified fraud risks in order to provide examiners with appropriate tools and techniques.*

Management Response: We agree with the recommendation to provide expanded tools and processes for staff, but not necessarily through the Red Flag Questionnaire.

The Red Flag Questionnaire is not meant to identify fraud but to recognize material weaknesses, allowing the examiner to expand the scope of the examination when concerns are identified. Region IV's Fraud Working Group is developing a questionnaire which will provide examination procedures for use when fraud is suspected. E&I will

[1] Examiners Guide, Chapter 3

Page 3

work with Region IV to ensure the questionnaires are progressive, expanding the scope of the exam as fraud or internal control weaknesses are identified and increasing the opportunity to detect specific fraud risks.

As noted above, the Small Credit Union Exam Program includes fraud detection scope procedures. These procedures, while designed for 'small' credit unions, can be used during any examination when fraud is suspected or risks are present. [redacted]

3. *Update policies and procedures to require third party confirmations be obtained regularly for all accounts where the balance or activity is significant to the operations of the credit union. In addition, NCUA management should require this as part of agreed-upon-procedures conducted by external CPA firms.*

Management Response: We agree that independent verification of account balances may assist in detecting internal control weaknesses and fraud. We agree with the recommendation to require confirmations of bank accounts and investments that are significant to the operations of the credit unions.

E&I has included the following step in the fraud detection scope of the Small Credit Union Exam Program:

[redacted]

Further, we recognize these confirmations should be required as part of the annual supervisory committee audit, regardless of the audit type chosen. We will include this in the next revision of the Supervisory Committee Guide, which provides the guidelines for non-opinion audits conducted at credit unions.

Thank you for the opportunity to comment.

cc: DED Kutchey
DEI Fazio
DDEI Segerson
DRM Komyathy
RD Morton
ARDO Bombarger
ARDP Avalos
OIG Senior Auditor Bruns
AMAC President Barton
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