

NATIONAL CREDIT UNION ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL

SEMIANNUAL REPORT  
TO  
THE CONGRESS

October 1, 2011 – March 31, 2012



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## **INSPECTOR GENERAL'S MESSAGE TO THE NCUA BOARD AND THE CONGRESS**

As this reporting period came to a close, the Office of Inspector General (OIG) took a retrospective view of where the credit union system was two years ago, and where it is now. Two years ago, the National Credit Union Administration (NCUA) had only begun to sort out its options for overcoming the crisis facing the corporate system. At the same time, the agency was confronting hundreds of CAMEL code 4 and 5 credit unions, 14 of which were over one billion dollars. Today, assets, shares, and return on assets have all increased, delinquencies and charge-offs have declined, and NCUA's corporate resolution is moving forward as planned, with no interruption of service to members. Still, while the recovery of the credit union system that began in 2010 gains momentum, the overall economic climate remains uncertain and instability of the financial markets lingers. We recognize that, as the NCUA and the OIG transition to a post-crisis period, it is more critical than ever that our work continues to contribute to the agency's obligation to operate as efficiently as possible and fulfill its responsibility to protect credit unions and their members from unacceptably risky actions.

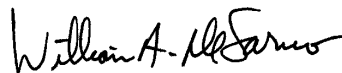
The OIG's audit and evaluation work over the past several years, and the NCUA's responsiveness to our many recommendations, reflect the positive and cooperative working relationship we established during the crisis. Since the inception of the crisis, the OIG has issued 18 Material Loss Reviews (MLRs). Our perspectives on the reasons for the losses to the National Credit Union Share Insurance Fund (NCUSIF) and, in some cases, credit union failures, were well received and, we believe, helped inform the NCUA, the Congress, and the public of the underlying circumstances of those losses and failures. With the abatement of the crisis, the OIG has seen—particularly during this reporting period—a significantly lighter workload of statutorily mandated MLRs. Consequently, we have been able to shift our focus to other challenges the NCUA currently faces, as reflected in our recent issuance of an audit report on NCUA's Asset Management Assistance Center (AMAC). That audit focused on the internal controls over the Asset Recovery, Liquidations of Member Services, and Accounting Services divisions, respectively, within AMAC, and an evaluation of AMAC's real estate owned (REO) activities. We placed particular emphasis on AMAC's REO activities in Florida as a result of the liquidations of Norlarco Credit Union and Huron River Area Credit Union, due to their size and complexity. We reported on several material weaknesses related to AMAC's REO valuation process and made specific recommendations to AMAC management.

On the investigative side of the house, early in the reporting period we welcomed a new Director of Investigations, Michael Egan, who came to us after serving for 12 years as a Criminal Investigator at the United States Postal Service Office of Inspector General. Mr. Egan's investigative skills were challenged during his first few weeks on board, when we received a referral from the NCUA Chairman requesting an investigation into an unlawful release of a 2010 NCUA examination report and CAMEL rating of the District Government Employees Federal Credit Union (DC FCU). Chairman Matz asked

for a full OIG investigation to determine which among the parties with access to the confidential examination information, whether NCUA or the credit union's board or management, was responsible for the disclosure. The investigation determined conclusively that no NCUA employee was involved in the disclosure. Rather, the Report of Investigation noted that the leak most likely came from a DC FCU Board member. Building on the OIG's ROI, the NCUA conducted its own investigation into the DC FCU Board member(s) allegedly responsible for the leak. On March 28, 2012, the NCUA issued an order prohibiting James M. Talbert from participating in the affairs of any federally insured credit union. The Prohibition Order cited Mr. Talbert for breaching his fiduciary duties in connection with his position at DC FCU by unlawfully disclosing non-public information.

This case demonstrates the value of leveraging OIG investigative resources to uncover unlawful activities that might place the stability of the credit union system at risk. It also illustrates our ongoing commitment to help ensure integrity in the credit union industry and bring justice to those—whether NCUA employees or credit union officials—who might undermine that integrity.

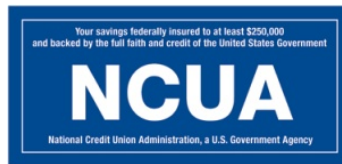
We look forward to continuing work with NCUA leadership, the Congress, and colleagues in the Inspector General community in helping maintain the stability and public confidence in the nation's credit union system.



William A. DeSarno  
Inspector General

## **THE NCUA MISSION**

NCUA's charge is to provide, through regulation and supervision, a safe and sound credit union system which promotes confidence in the national system of cooperative credit.



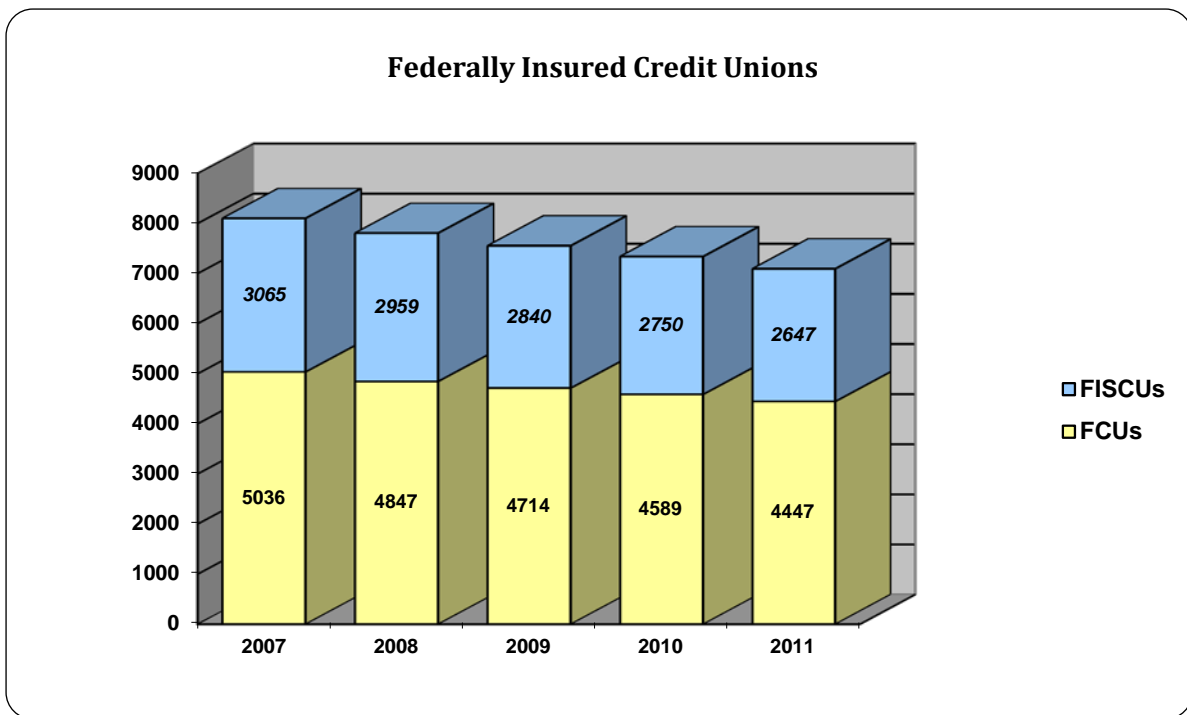
## **THE OFFICE OF INSPECTOR GENERAL MISSION**

The OIG promotes the economy, efficiency, and effectiveness of NCUA programs and operations, and detects and deters fraud, waste, and abuse, thereby supporting the NCUA's mission of monitoring and promoting safe and sound federally insured credit unions.

We accomplish our mission by conducting independent audits, investigations, and other activities, and by keeping the NCUA Board and the Congress fully and currently informed of our work.

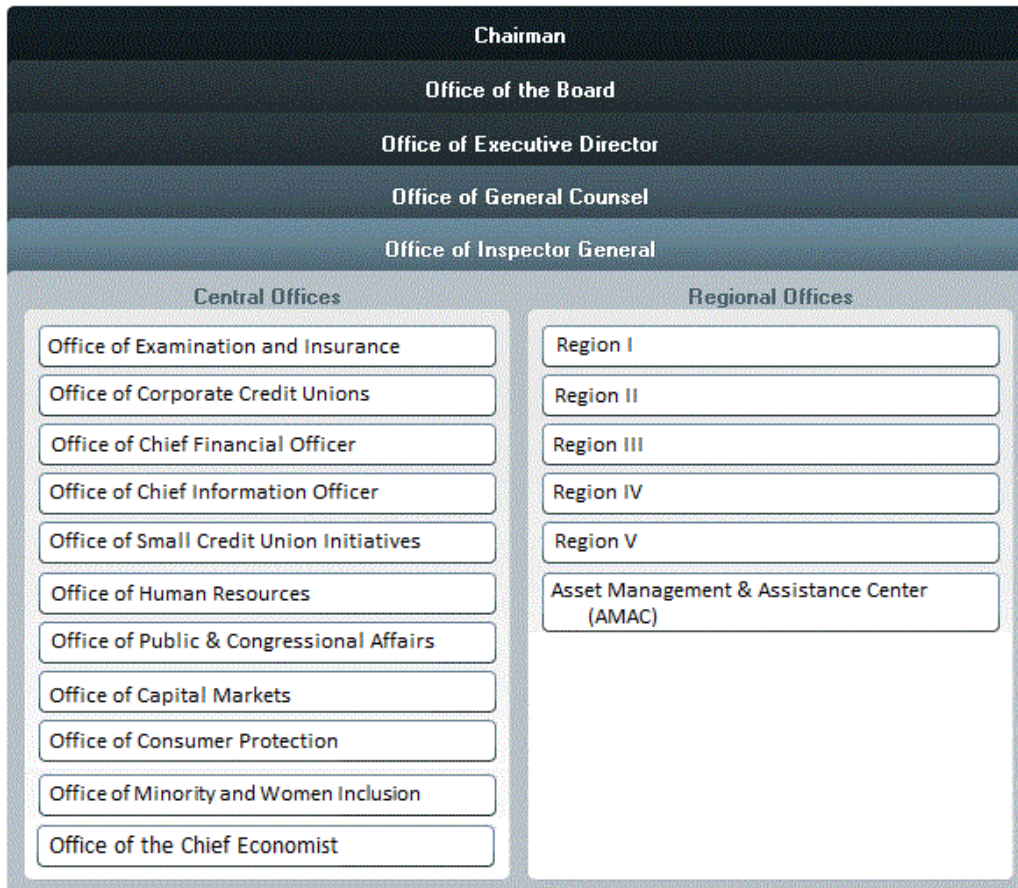
## INTRODUCTION

The NCUA was established as an independent, federal regulatory agency on March 10, 1970. The agency is responsible for chartering, examining, supervising, and insuring federal credit unions. It also insures state-chartered credit unions that have applied for insurance and have met National Credit Union Share Insurance requirements. The NCUA is funded by the credit unions it supervises and insures. As of December 31, 2011, the NCUA was supervising and insuring 4,447 federal credit unions and insuring 2,647 state-chartered credit unions, a total of 7,094 institutions. This represents a decline of 142 federal and 103 state-chartered institutions since December 31, 2010, for a total decline of 245 credit unions nationwide, primarily as a result of mergers and liquidations.

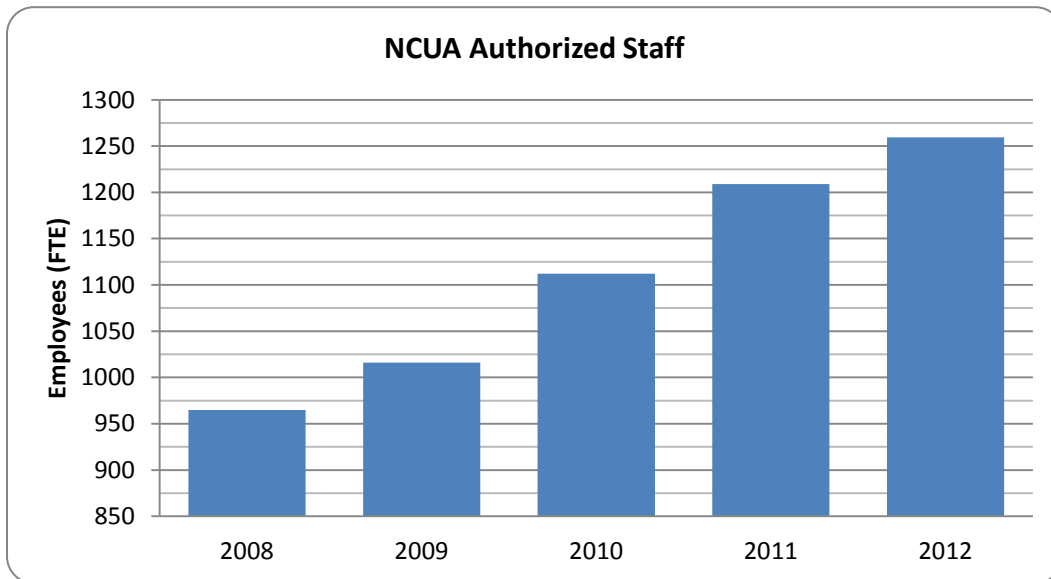
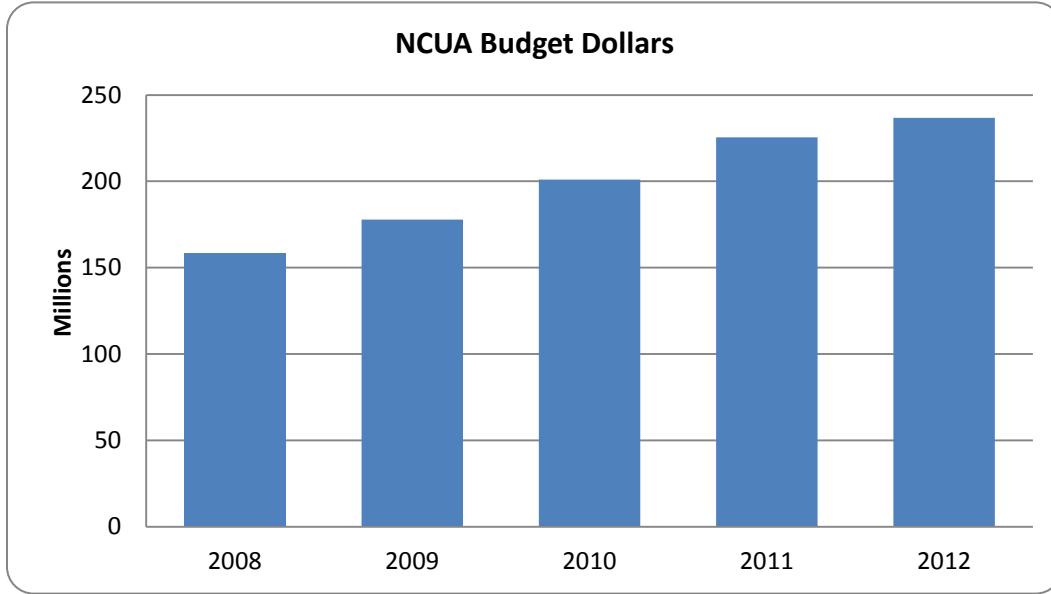


The NCUA operates under the direction of a Board composed of three members. Board members are appointed by the President and confirmed by the Senate. They serve six-year terms. Terms are staggered, so that one term expires every two years. The Board is responsible for the management of the NCUA, including the NCUA Operating Fund, the Share Insurance Fund, the Central Liquidity Facility, the Community Development Revolving Loan Fund, and the Temporary Corporate Credit Union Stabilization Fund.

The NCUA executes its program through its central office in Alexandria, Virginia and regional offices in Albany, New York; Alexandria, Virginia; Atlanta, Georgia; Austin, Texas; and Tempe, Arizona. The NCUA also operates the Asset Management and Assistance Center (AMAC) in Austin, Texas. Please refer to the NCUA organizational chart below.



The NCUA Board adopted its 2012 budget of \$236,854,786 on November 17, 2011. The Full-Time Equivalent (FTE) staffing authorization for 2012 is 1,259.50 representing an increase of 33 FTEs from 2011.





## NCUA HIGHLIGHTS

### NCUA Appointed Telesis Community Credit Union Conservator

On March 23, 2012, the California Department of Financial Institutions placed Telesis Community Credit Union (Telesis) into conservatorship and immediately appointed the NCUA as conservator. Telesis is a state-chartered, federally insured credit union headquartered in Chatsworth, California. Deposits at Telesis are protected by NCUA up to \$250,000. Administered by the NCUA, the NCUSIF has the backing of the full faith and credit of the U.S. Government.

The state placed Telesis into conservatorship due to a declining financial condition. During the conservatorship, service to Telesis' members will continue without interruption, and members can continue to conduct normal financial transactions.

Originally chartered in 1965, Telesis' field of membership currently includes, among others, various employer groups and individuals who live, work, worship, or go to school in the San Fernando and Santa Clarita valleys or in Ventura County. With assets reported at \$318.3 million in the latest Call Report, Telesis has more than 37,600 members. The Federal Credit Union Act authorizes the NCUA Board to accept appointment as conservator when necessary to conserve the assets of a federally insured credit union, protect members' interests, or protect the NCUSIF. Telesis is the third federally insured credit union placed into conservatorship in 2012.

### NCUA National Credit Union Share Insurance Fund Ends 2011 in Stronger Position

The NCUA Board convened its second open meeting of 2012 at the agency's headquarters in Alexandria, Virginia on March 15, 2012, and received an update on the performance of the NCUSIF. The NCUSIF ended 2011 in a stronger position as a result of fewer losses, portfolio growth, and a decline in at-risk credit unions, among other factors. As a result, NCUA transferred \$278.6 million in equity from the NCUSIF to the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund). The Federal Credit Union Act requires NCUA to transfer any NCUSIF equity above the normal operating level of 1.30 percent at year-end as long as the Stabilization Fund has outstanding borrowings from the U.S. Treasury.

NCUA calculated the 1.30 percent equity ratio for 2011 on an insured share base of \$795.3 billion. By comparison, the NCUSIF equity ratio at the end of 2010 stood at 1.28 percent on an insured share base of \$757.9 billion. The growth in credit union insured shares for 2011 was nearly 5 percent. The value of the NCUSIF portfolio grew about 4 percent during 2011 to close the year with a value of \$10.7 billion.

Other positive, year-over-year trends contained in the 2011 year-end NCUSIF report presented to the Board included:

- Credit union failures dropped by more than 40 percent to 16 failures from 28 failures.
- The total amount of losses associated with credit union failures dropped 75 percent to \$55 million from \$221 million.
- The total number of CAMEL code 3, 4, and 5 credit unions dropped to 2,150 from 2,192.
- The total assets of CAMEL code 4 and 5 credit unions fell 32 percent to \$29.4 billion from \$43.3 billion.

- The total assets of CAMEL code 3 credit unions decreased 9 percent to \$142.5 billion from \$156.7 billion.

On the strength of these positive trends and other factors, NCUA's reserving methodology allowed for a reduction in the NCUSIF's reserves by 51 percent to \$606.6 million at year-end 2011 from \$1.2 billion at year-end 2010.

In light of the steady improvements, NCUA did not collect an NCUSIF premium in 2011. At the open NCUA Board meeting in November 2011, Chairman Matz had announced a reduction in the projected NCUSIF premium range for 2012 down to 0-6 basis points.

### [NCUA Settles Claims Against HSBC](#)

On March 12, 2012, NCUA and HSBC reached a settlement regarding potential claims relating to the sale of residential mortgage-backed securities to five failed wholesale credit unions. HSBC agreed to pay NCUA \$5.25 million to reduce the losses associated with the five failures. The settlement with HSBC does not admit fault on their part. NCUA will use the net proceeds from the settlement to further reduce assessments being charged to credit unions to pay for the losses.

NCUA to date has received a total of \$170.75 million in settlement proceeds. Losses from wholesale credit union failures are paid from the Stabilization Fund. Expenditures from this fund must be repaid through assessments against all federally insured credit unions. Thus, recoveries such as the HSBC settlement reduce the amount of future assessments on credit unions.

Since 2009, NCUA has assessed credit unions \$3.3 billion to pay for losses associated with the five corporate credit failures. Given the current settlement proceeds, projections for remaining assessments range between \$1.8 billion and \$6.1 billion that must be repaid by 2021. Corporate credit unions are wholesale credit unions that provide services to retail credit unions, which in turn serve consumers. Consumer credit unions rely on corporate credit unions for services such as check clearing, electronic payments, and investments.

### [NCUSIF Earns Clean Audit for 2011](#)

The NCUA, on February 16, 2012, released 2011 audited financial reports for the agency's four permanent funds (the NCUSIF; the Central Liquidity Facility (CLF); the Community Development Revolving Loan Fund (CDRLF) and the Operating Fund). All four funds received unqualified or "clean" audit opinions, including the NCUSIF that protects deposits up to \$250,000 for more than 91 million consumers at federally insured credit unions. KPMG LLP completed the audits of all four funds. KPMG will issue an opinion about the 2011 financial statements for the Stabilization Fund in the coming months. The Stabilization Fund earned a clean audit for 2010. The four financial reports are available at:

[www.ncua.gov/about/Leadership/CO/OIG/Pages/AuditRpt.2012.aspx](http://www.ncua.gov/about/Leadership/CO/OIG/Pages/AuditRpt.2012.aspx).

### [New NCUA Policy Will Keep Credit Union Members in Their Homes](#)

At its January 26, 2012, Board meeting, the NCUA Board approved a proposed rule and guidance on troubled debt restructuring (TDR) to facilitate mortgage modifications and assist credit union members in keeping their homes. In a proposed rule and Interpretative Ruling and Policy Statement on TDRs, the Board sought to balance the need to effectively balance appropriate loan workout programs for financially distressed credit union members with potential safety-and-soundness considerations in order to help keep more families in their homes.

Specifically, the TDR proposal:

- Establishes consistent standards for the management of loan workout arrangements that assist borrowers;
- Streamlines regulatory reporting requirements related to TDR loans by removing manual tracking and eliminating confusion between TDRs and other loan modifications; and
- Reaffirms the existing policy and practice with the credit union industry of placing loans on nonaccrual status when they reach 90 days past due.

Credit unions will be able to modify loans without having to immediately classify TDR loans as delinquent. Additionally, credit unions will not have to track each TDR loan's performance manually for six months, as is the current requirement. In developing a written policy in this area, the proposed TDR guidance would allow credit union boards and management to consider similar parameters as those previously established by the Federal Financial Institutions Examination Council (FFIEC).

NCUA issued the proposed guidance on February 1, 2012, with a 30-day comment period. Thirteen Federally Insured Credit Unions (FICUs), an accounting firm, a non-profit consumer advocate, and two industry trade groups supported the elimination of the current requirement to track and report TDRs as delinquent until six consecutive payments. Several commenters noted the change was a needed improvement, as the current reporting requirement has been problematic for many FICUs and an obstacle to helping members.

#### [NCUA, NTEU Sign Collective Bargaining Agreement](#)

On November 1, 2011, NCUA Chairman Debbie Matz and National Treasury Employees Union (NTEU) President Colleen Kelley signed a new, three-year collective bargaining agreement (CBA). NCUA and NTEU worked collectively to reach a full agreement in the face of difficult national economic circumstances. The two sides discussed and negotiated a total of 27 articles on major topics such as employee pay and benefits, travel expense reimbursement, promotions, employee rights, employee time and leave, and health and wellness.

The agreement modernizes the employee benefits package to make it competitive with the other federal financial regulatory agencies as required by Congress. To offset the costs of the benefits, the employees agreed to a pay freeze that is not statutorily applied to NCUA. The trade of pay for benefits had a neutral effect on the 2012 budget.

The CBA also revised the employee relocation package to attract employees to higher-graded positions and management positions. The goal of these provisions was to improve succession planning as more managers become retirement eligible. Finally, the CBA streamlines administrative and reporting processes to maximize employee and management productivity.

NTEU represents approximately 950 of NCUA's nearly 1,200 employees.

## FEDERALLY INSURED CREDIT UNION HIGHLIGHTS

Credit unions submit quarterly call reports (financial and operational data) to the NCUA. An NCUA staff assessment of the December 31, 2011, quarterly call reports submitted by all federally insured credit unions found that key financial indicators are mixed.

### Key Financial Indicators Mixed

Looking at the December 31, 2011 quarterly statistics for major balance sheet items and key ratios shows the following for the nation's 7,094 federally insured credit unions: assets grew 5.19 percent; net worth to assets ratio increased from 10.06 to 10.23 percent; the loan to share ratio decreased from 71.81 percent to 69.07 percent. However, the delinquency ratio decreased from 1.76 to 1.60 percent; and credit union return on average assets increased from .50 percent to .68 percent.

### Savings Shifting to Regular Shares

Total share accounts increased 5.21 percent. Regular shares increased 10.95 percent. Regular shares comprise 29.57 percent of total share accounts; share certificates comprise 24.67 percent; money market shares comprise 22.86 percent; share draft accounts comprise 12.19 percent; and all other share accounts comprise 10.72 percent.

### Loan Volume Flat

Loans increased 1.20 percent resulting in an increase in total loans by \$6.8 billion. Total net loans of \$571 billion comprise 59.42 percent of credit union assets. First mortgage real estate loans are the largest single asset category with \$232.4 billion accounting for 40.67 percent of all loans. Other real estate loans of \$80.5 billion account for 14.09 percent of all loans. Used car loans of \$106.7 billion were 18.68 percent of all loans, while new car loans amounted to \$58.2 billion or 10.2 percent of total loans. Credit card loans totaled \$37.4 billion or 6.54 percent of total loans and other loans totaled \$56.1 billion for 9.83 percent of total loans.

## LEGISLATIVE HIGHLIGHTS

### Senator Udall Reintroduces the Small Business Lending Enhancement Act

On March 22, 2012, Sen. Mark Udall (D-Colo.) reintroduced the *Small Business Lending Enhancement Act* as S. 2231. Identical to S. 509 and H.R. 1418, the bill currently has 21 co-sponsors. It would allow NCUA to raise a credit union's MBL cap from 12.25 percent of assets to 27.5 percent if:

- it is well capitalized (currently, have at least a 7 percent net worth ratio);
- it has at least five years of MBL experience;
- it is at or above 80 percent of current authority for at least one year before application; and
- it has demonstrated sound underwriting and servicing based on historical performance and strong management.

A credit union allowed to pursue the higher MBL cap would be limited to 30 percent growth annually in its MBL portfolio.

### NCUA Testifies on Exam Reform Bill

On February 1, 2012, NCUA Executive Director David Marquis testified before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit on H.R. 3461, the *Financial Institutions Examination Fairness and Consumer Credit Reform Act*. Marquis noted that NCUA has already adopted a number of examination practices that fall in line with the legislation. Marquis testified that, consistent with H.R. 3461, NCUA has prioritized the timely delivery of findings, so that exams are promptly completed and credit unions may quickly address small issues before they grow into big ones. He noted NCUA's zero-tolerance policy to prevent retaliation against credit unions that appeal their findings. Marquis also pointed out that every NCUA exam report contains a cover page that explains a credit union's appeal rights and references to NCUA's policy on appeals and non-retaliation.

Marquis' testimony also identified significant unintended consequences of H.R. 3461, including increased administrative costs, higher risks for the NCUSIF, and the imposition of a one-size-fits-all approach in the examination of financial institutions.

### Senate Introduces S. 2105, the *Cybersecurity Act of 2012*.

On February 14, 2012, Senators Lieberman, Collins, Rockefeller, and Feinstein introduced S. 2105, the *Cybersecurity Act of 2012*. The bill requires the Department of Homeland Security (DHS) to combine its cybersecurity programs into a unified office called the National Center for Cyber-Security and Communications. The bill further grants DHS the authority to establish standardized cybersecurity protocols for private companies engaged in the operation of the nation's critical infrastructure. The bill also calls for increased sharing of cyber-threat information between private companies and the federal government, and replaces the industry's longstanding regulator on issues of cybersecurity—the Department of Treasury—with a new agency, DHS. Finally, the bill includes significant revisions to the *Financial Information Security Management Act*.

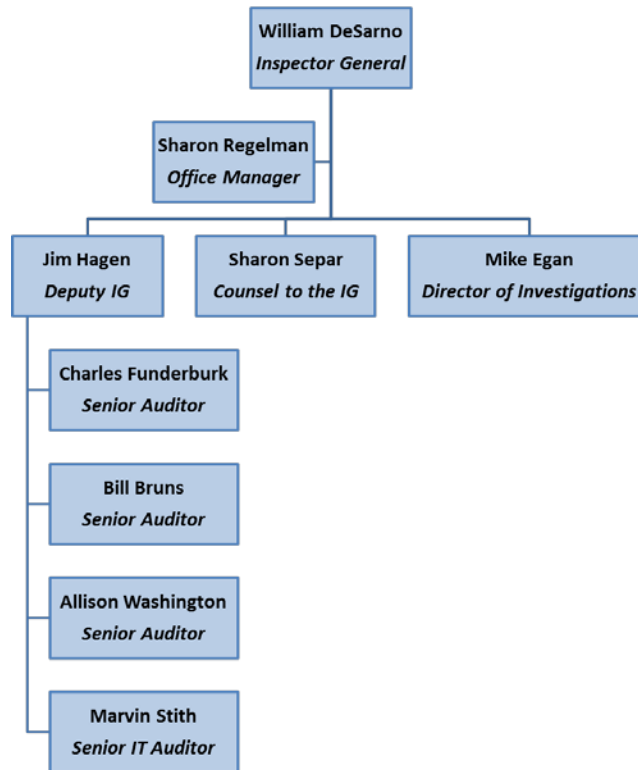
## OFFICE OF THE INSPECTOR GENERAL

The Office of the Inspector General was established at the NCUA in 1989 under the authority of the Inspector General Act of 1978, as amended. The staff consists of the Inspector General, Deputy Inspector General, Counsel to the Inspector General, Director of Investigations, three Senior Auditors, Senior Information Technology Auditor, and Office Manager.

The Inspector General reports to, and is under the general supervision of, the NCUA Board. The Inspector General is responsible for:

1. Conducting, supervising, and coordinating audits and investigations of all NCUA programs and operations;
2. Reviewing policies and procedures to ensure efficient and economic operations as well as preventing and detecting fraud, waste, and abuse;
3. Reviewing existing and proposed legislation and regulations to evaluate their impact on the economic and efficient administration of agency programs; and
4. Keeping the NCUA Board and the Congress apprised of significant findings and recommendations.

### NCUA OIG ORGANIZATIONAL CHART



## AUDIT ACTIVITY

### AUDIT REPORTS ISSUED

*OIG-11-12 – November 10, 2011*

Independent Evaluation of the NCUA's Compliance with the *Federal Information Security Management Act (FISMA) 2011*

The Office of Inspector General (OIG) for the National Credit Union Administration (NCUA) engaged Richard S. Carson and Associates, Inc. (Carson Associates), to independently evaluate its information systems and security program and controls for compliance with the *Federal Information Security Management Act (FISMA)*, Title III of the E-Government Act of 2002.

Carson Associates evaluated NCUA's security program through interviews, documentation reviews, technical configuration reviews, and sample testing. We evaluated NCUA against standards and requirements for federal government agencies such as those provided through FISMA, the Government Accountability Office's *Federal Information System Controls Audit Manual (FISCAM)*, National Institute of Standards and Technology (NIST) Special Publications (SPs), and Office of Management and Budget (OMB) memoranda.

NCUA has worked to further strengthen its information security and privacy programs during Fiscal Year (FY) 2011. NCUA's accomplishments during this period include:

- Improved its security configuration for servers and desktops;
- Improved its ability to establish a fully integrated continuous monitoring program by implementing automated software, which includes intrusion detection, vulnerability scanning, and logging tools;
- Developed and implemented policies and procedures for overseeing external service providers;
- Improved its contingency planning program for its FISMA systems;
- Established, implemented and enforced security baselines for its servers and desktop devices;
- Improved its Plan of Action and Milestone process;
- Provided Business Impact Assessments (BIAs) for its FISMA systems and is currently extending the BIA study down to its regional/field offices;
- Improved its procedures for ensuring terminated users and inactive user accounts are disabled or removed from NCUA systems; and
- Implemented continuing education requirements for its information technology employees.

We identified two areas remaining from last year's FISMA evaluation that NCUA officials need to address. NCUA needs to:

- Improve remote access controls; and
- Improve its privacy program (i.e., review its use of Personally Identifiable Information and Social Security Numbers).



In addition, we identified four new findings this year where NCUA could improve its information technology security controls. Specifically, NCUA needs to:

- Improve its continuous monitoring program;
- Improve its security authorization packages;
- Improve its contingency planning program; and
- Improve its intrusion detection policies and procedures.

*OIG-11-13 – December 27, 2011*

[NCUA Financial Statement Audit of the Temporary Corporate Credit Union Stabilization Fund \(TCCUSF\)](#)

Our contracting audit firm, KPMG LLP, issued its opinion on the 2010 financial statements of the National Credit Union Administration Temporary Corporate Credit Union Stabilization Fund. The auditors found that the financial statements presented fairly the financial position of the agency fund as of December 31, 2010 and issued an **unqualified opinion** on the TCCUSF's financial statements.

*OIG-12-01/02/03/04 – February 16, 2012*

[NCUA Financial Statements Audit 2011: Operating Fund, Central Liquidity Facility, Community Development Revolving Loan Fund, and Share Insurance Fund](#)

Our contracting audit firm, KPMG LLP, issued opinions on the 2011 financial statements of the National Credit Union Administration Operating Fund, Central Liquidity Facility, Community Development Revolving Loan Fund, and the National Credit Union Share Insurance Fund. The auditors found that the financial statements presented fairly the financial position of the agency's funds as of December 31, 2011.

[The NCUA Operating Fund \(OIG-12-01\)](#) was established as a revolving fund managed by the NCUA Board for the purpose of providing administration and service to the federal credit union system. The auditors issued an **unqualified opinion** on the Operating Fund's financial statements. The fund's total assets for 2011 were \$79.6 million, up from \$75.6 million in 2010.

[The Central Liquidity Facility \(OIG-12-02\)](#) was established as a mixed ownership government corporation managed by the NCUA Board to improve general financial stability by meeting the liquidity needs of credit unions. The auditors issued an **unqualified opinion** on the Central Liquidity Facility's (CLF) financial statements. The CLF's total assets for 2011 were \$2.1 billion, up from \$2 billion in 2010.

[The Community Development Revolving Loan Fund's \(OIG-12-03\)](#) purpose is to stimulate economic activities in the communities served by low-income credit unions. This in turn will result in increased income, ownership and employment opportunities for low-wealth residents and other economic growth. The auditors issued an **unqualified opinion** on the Fund's financial statements. The Community Development Revolving Loan Fund's total assets for 2011 were \$17.1 million, unchanged from 2010.

[The National Credit Union Share Insurance Fund \(OIG-12-04\)](#) was established as a revolving fund managed by the NCUA Board to insure member share deposits in all Federal credit unions and qualifying state credit unions. The auditors issued an **unqualified opinion** on the Share Insurance Fund's financial statements. The Fund's total assets for 2011 were 11.7 billion, up from \$11.1 billion in 2010.



*OIG-12-05 – February 29, 2012***Material Loss Review of Vensure Federal Credit Union**

The NCUA OIG contracted with Crowe Horwath LLP (Crowe) to conduct a Material Loss Review (MLR) of Vensure Federal Credit Union (Vensure). Although the anticipated loss to the National Credit Union Share Insurance Fund (NCUSIF) for Vensure does not meet the statutory loss threshold to require a MLR, we identified the circumstances surrounding the failure of Vensure to be unusual in nature and therefore determined a MLR should be performed. We reviewed Vensure to: (1) determine the cause of the failure and resulting loss to the NCUSIF, (2) assess NCUA's supervision of the credit union, and (3) make appropriate recommendations to prevent future losses.

Our review determined Vensure failed due to the seizure of funds from its largest depositor due to: (1) the member's involvement in processing on-line gambling transactions; (2) exposure to excessive amounts of risk by Vensure's management and Board due to its affiliation with on-line gambling business settlement activity; and (3) an overall weak business model. In addition, we determined NCUA Region I examiners could have prevented or mitigated the loss to the NCUSIF had they adequately identified and more aggressively pursued the nature of Vensure's primary source of income, ACH related fee activity, which was later determined to be tied to a criminal violation of the Unlawful Internet Gambling Enforcement Act.

This report includes numerous observations and lessons learned, as well as makes two recommendations we believe will help examiners as they perform risk-focused examinations. NCUA Management agreed with our recommendations and the actions taken and planned will address the issues identified in this report.

*OIG-12-06 – March 19, 2012***Audit of the NCUA's Asset Management Assistance Center**

The NCUA OIG engaged Crowe Horwath LLP, to independently conduct a performance audit on NCUA's Asset Management Assistance Center (AMAC) to determine the efficiency and effectiveness of: 1) policies/procedures and internal controls for asset recovery, liquidations of member services, and accounting services; 2) payments of share accounts including closing out the account or return checks that occur; and 3) valuation process and disposal of property and assets.

Our audit focused on the internal controls over the Asset Recovery, Liquidations of Member Services, and Accounting Services divisions within AMAC. We evaluated payments of share accounts, closing out the accounts or return checks that occur, and the valuation process and disposal of property and assets. One of the main areas of focus of our audit was related to the liquidations of Norlarco Credit Union and Huron River Area Credit Union. We considered this a major focus of our audit due to the size and complexity of these liquidations. Therefore, we included a section in this report analyzing the results of these liquidations.

Based on our analysis, we found deficiencies in the valuation process of real estate owned (REO) by AMAC. Specifically, AMAC did not perform valuations on these properties in accordance with industry standards and did not always maintain proper support for the valuations that were completed. In addition, we determined AMAC did not formally complete a cost to carry analysis on REO. We believe AMAC should have completed this type of analysis as part of its determination regarding whether to sell or hold real estate.

We made nineteen recommendations in the report to improve AMAC operations. Management agreed and has taken or plans to take corrective action on each of the recommendations.

## AUDITS IN PROGRESS

### NCUA Temporary Corporate Credit Union Stabilization Fund Financial Statement 2011

Our current contracting audit firm, KPMG, is working on the 2011 financial statements of the NCUA Temporary Corporate Credit Union Stabilization Fund (TCCUSF).

The TCCUSF, established in 2009, allows NCUA to borrow money from the Treasury to pay for corporate credit union losses, and then pay back the Treasury over time with funds obtained from assessments on federally insured credit unions. Due to extraordinary circumstances related to the complexity of this area, the audit of these financial statements has taken longer than anticipated. We expect to issue our report by late June 2012.

### Material Loss Review of O.U.R. Federal Credit Union

The Federal Credit Union Act requires the NCUA OIG to conduct a MLR of an insured credit union if the loss exceeds \$25 million. The *Dodd-Frank Wall Street Reform and Consumer Protection Act* requires the OIG to assess all losses to the NCUSIF under the \$25 million threshold and determine if unusual circumstances warrant a MLR. We determined that O.U.R. credit union met this criterion and elected to conduct a MLR.

We are in the process of conducting a MLR on O.U.R. FCU. We will review O.U.R. FCU to (1) determine the cause(s) of the credit union's failure and the resulting loss to the NCUSIF; and (2) assess NCUA's supervision of the credit union. To achieve these objectives, we will analyze NCUA examination and supervision reports and related correspondence; interview management and staff from NCUA Regional offices; and review NCUA guidance, policies and procedures, NCUA Call Reports, and Financial Performance Reports.

### Review of NCUA's Controls over Sensitive and Proprietary Information

The OIG is initiating a review of NCUA's Controls over Sensitive and Proprietary Information Associated with the Financial Stability Oversight Council (FSOC) and FSOC Member Agencies.

The *Dodd-Frank Wall Street Reform and Consumer Protection Act* created the Council of Inspectors General on Financial Oversight (CIGFO), in part, to evaluate the effectiveness and internal operations of the FSOC. On December 8, 2011, CIGFO members approved a proposal to convene a working group to review FSOC's control of sensitive and proprietary information. We are conducting this review - concurrently with reviews by the other CIGFO members - in support of the CIGFO's 'Audit of the Financial Stability Oversight Council's Controls over Sensitive and Proprietary Information'. The results from our report will be incorporated into the CIGFO final report.

Our objective is to review NCUA's policies, procedures, and practices for ensuring FSOC-related information that it collects, shares, or deliberates is adequately protected from unauthorized disclosure. Depending on our findings, we may elect to issue a separate report to NCUA Management.

### Review of NCUA's Examination Process for Small Credit Unions

The OIG is initiating a review of NCUA's examination process for small credit unions and the ability to ensure credit unions can question examination results.

In response to a February 10, 2012, request from the Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, we are initiating an audit of the NCUA examination process for small credit unions. Our objectives, consistent with the request, are to determine (1) the NCUA's examination process for small credit unions, including examination timelines and how NCUA ensures consistency in the administration of exams across the country; and (2) the ability of insured credit unions to question examination results, such as through NCUA's Ombudsman, the appeal process, or informal channels, and the frequency and success of such appeals.

### Review of NCUA's Red Flag Reports

The OIG is initiating a review of NCUA's document of resolution follow-up process. This is a discretionary audit from the NCUA OIG's 2012 Annual Audit Plan.

A red flag is an indicator/warning sign of a potential problem or issue. During our material loss reviews, we analyzed 5300 data that highlighted areas of increased risk that may have helped examiners identify potential safety and soundness issues. NCUA uses red flag reports to target credit unions that have potential high risk areas.

The objective of this audit is to determine whether examiners are identifying and addressing high risk areas.

### SIGNIFICANT AUDIT RECOMMENDATIONS ON WHICH CORRECTIVE ACTION HAS NOT BEEN COMPLETED

As of March 31, 2012, below is a list of OIG reports with unimplemented recommendations where management has agreed to implement corrective action but has not completed. This information is based on (1) information supplied by NCUA Office of Examination and Insurance and (2) the OIG's report recommendation tracking system.

#### Report Number, Title and Date

OIG-10-20 OIG Capping Report on Material Loss Reviews, November 23, 2010

#### Significant Recommendations Open and Brief Summary

On November 23, 2010 the OIG issued report #OIG-10-20 titled OIG Capping Report on Material Loss Reviews. There are 11 open recommendations related to the examination and supervision procedures for overseeing credit unions. These issues include documentation, monitoring, ratings, call reports, third party relationships, due diligence, exam procedures, quality control reviews and regulatory guidance. We have determined that NCUA has made significant progress and is in various stages of implementing corrective action on all 11 of these recommendations.

## REPORT ON CREDIT UNION LOSSES UNDER MATERIALITY LEVEL OF \$25 MILLION

Section 988 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* did two things relative to MLRs of credit unions which incurred a loss to the NCUSIF.

First, the threshold for a mandated MLR was raised to \$25 million or greater loss to the NCUSIF starting on the implementation date of the Act (July 21, 2010) and going forward.

Second, the NCUA OIG is now required to (1) perform limited reviews of all credit union failures and/or losses to the NCUSIF under the threshold to assess whether an in-depth review (consistent with the scope of a MLR) is warranted; and (2) report to the NCUA Board and the Congress every 6 months on the results of the limited reviews and the timeframe for performing any in-depth reviews we determine are necessary.

This report on losses not reaching \$25 million covers the six month period from October 1, 2011 to March 31, 2012. For all losses to the NCUSIF under the MLR threshold, we determined (1) why NCUA initiated assistance and (2) whether any unusual circumstances existed that might warrant an in-depth review of the loss.

For each limited review, we performed procedures that included but were not limited to: 1) obtaining and analyzing the regulator's supervisory memorandum and other pertinent documents; 2) preparing a schedule of CAMEL ratings assigned to the institution through full scope or other examinations during the five years preceding the failure; 3) conducting interviews as needed; 4) inquiring about any investigative actions that were taken, planned, or considered involving credit union officials or others; and 5) analyzing supervisory history and other review methods.

We conducted limited reviews of eight failed credit unions that incurred losses to the NCUSIF under \$25 million between October 1, 2011 and March 31, 2012. Based on those limited reviews, we determined that two of the losses warranted conducting additional work. For the six failed credit unions for which we do not intend to conduct additional work, we concluded that either 1) no unusual circumstances presented themselves in our review, or 2) we had already addressed the reasons identified for failure in recommendations to the agency in our Material Loss Review Capping report or other MLR reports.

The chart below provides details on the eight credit union losses to the NCUSIF of less than \$25 million. It provides details on the credit union such as supervision, date of failure, estimated loss to the NCUSIF, and grounds for conservatorship, merger, or other factors. The chart also provides our decision whether to terminate or proceed with an MLR of the credit union.

Decision*	Credit Union	Region	Date of Failure	Est. Loss to NCUSIF	Grounds for the NCUA Appointment
Terminate	St. James AME Federal Credit Union	II	11/17/2011	\$261,131	Insolvent due to unsafe and unsound management practices that included poor recordkeeping, significantly underfunded Allowance for Loan and Lease Losses account, escalating delinquency, refusal to recognize and charge-off non-performing loans, poor loan underwriting, weak collection efforts, high operating expenses, lack of profitability, weak and declining capital, and ineffective and uncooperative management.
Terminate	BCT Federal Credit Union	I	11/30/2011	\$431,000	Insolvent due to the unsafe and unsound management practice of allowing loan concentration in excess of regulatory limits. The board, management, and supervisory committee failed to perform appropriate due diligence relative to the loan concentration and comply with NCUA examination recommendations.
Proceed with MLR	O.U.R. Federal Credit Union	V	12/2/2011	\$3,740,000	Insolvent due to unsafe and unsound management practices related to suspected fraud committed by a former manager. The FBI opened an investigation into the matter as credit union shares were out of balance by nearly \$1.6 million.
Terminate	Birmingham Financial Federal Credit Union	III	12/15/2011	\$41,319	Insolvent due to management operating the credit union in an unsafe and unsound manner including a serious conflict of interest with the credit union's sponsor, a continuous lack of action by management to address issues, persistent non-compliance with established timelines for submitting reports, and problems with the credit union's books and records.

Terminate	Kunia Federal Credit Union	V	12/16/2011	\$1,210,000	Insolvent due to management allowing high delinquency and loan losses stemming from a weak loan portfolio. Any NCUSIF assistance would exceed the cost of a merger.
Proceed with MLR	Eastern New York Federal Credit Union	I	1/27/2012	\$3,600,000	Insolvent due to management allowing the credit union to become critically undercapitalized. The former CEO operated the credit union in an unsafe and unsound manner through lending activities involving CUSOs that he was secretly involved with. The CEO involved the credit union in an expensive branch expansion and questionable member business lending practices. The potential for fraud exists related to the CEO's CUSO activities.
Terminate	H.B.E. Credit Union	IV	2/06/2012	\$332,061	Insolvent due to embezzlement and fictitious accounting records by a former manager.
Terminate	HHA Federal Credit Union	IV	3/28/2012	\$50,254	Insolvent due to deteriorated financial condition stemming from substandard underwriting, sub-prime loans, excessive delinquency, and weak loan internal controls. Management also allowed questionable member business lending practices.

#### DECISIONS REGARDING LOSSES LESS THAN \$25 MILLION

\*Criteria for the decisions included: (1) dollar value and/or percentage of loss; (2) institutions background, such as charter type and history, geographic location, affiliations, business strategy; (3) uncommon cause of failure based on prior MLR findings; (4) unusual supervisory history, including the nature and timing of supervisory action taken, noncompliance with statutory examination requirements, and/or indications of rating disagreements between the state regulator and NCUA; and (5) other, such as apparent fraud, request by NCUA Chairman or management, Congressional interest, or IG request.

## PEER REVIEWS

### OCTOBER 1, 2011 THROUGH MARCH 31, 2012

*Government Auditing Standards* require audit organizations that perform audits and attestation engagements of federal government programs and operations undergo an external peer review every three years. The objectives of an external peer review include a review of an audit organization's system of quality control to determine not only the suitability of the design, but also whether the audit organization is in compliance with its quality control system so as to provide reasonable assurance the audit organization conforms to applicable professional standards.

### EXTERNAL PEER REVIEW OF NCUA OIG OFFICE OF AUDIT

Although the NCUA OIG did not undergo an external peer review during the current semiannual period, the U.S. Securities and Exchange Commission (SEC) OIG completed our most recent peer review on May 7, 2010 for the three-year period ending October 31, 2009. The SEC OIG issued its report entitled NCUA System Review and rendered the opinion that the system of quality control for the NCUA OIG, Office of Audit, was suitably designed and complied with, thus providing reasonable assurance the system of controls conformed with applicable professional standards in all material respects. As a result, we received a peer rating of pass. In addition, we have no outstanding recommendations from this external peer review. A copy of this most recent peer review report is included herein as Appendix A.

### EXTERNAL PEER REVIEW OF NATIONAL LABOR RELATIONS BOARD OIG OFFICE OF AUDIT

The NCUA OIG completed a peer review of the National Labor Relations Board (NLRB) OIG. On October 31, 2011, we issued an external peer review report for the audit function of the NLRB OIG for the three year period ended September 30, 2011. The NLRB received a rating of pass and has no outstanding recommendations related to the peer review report



## INVESTIGATIVE ACTIVITY

In accordance with professional standards and guidelines established by the United States Department of Justice, the OIG Office of Investigations conducts investigations of serious or criminal misconduct on the part of NCUA employees and contractors to ensure a working environment of high integrity. Our investigations may involve possible violations of agency regulations and policies, as well as Federal criminal law, and other statutes and regulations.

In addition, the Office of Investigations receives complaints from credit unions and their members which involve NCUA employee program responsibilities. We examine these complaints and determine if there is any indication of NCUA employee misconduct. If not, we refer the complaints to the NCUA Office of Consumer Protection (OCP) or the appropriate regional office for response.

### OIG HOTLINE CONTACTS

The OIG maintains a 24-hour toll free hotline to enable employees and citizens to call in and provide information regarding potential fraud, waste, and abuse or mismanagement in the agency's programs and/or operations. Additionally, the OIG office receives complaints in its off-site post office box, and through electronic mail and facsimile transmission. All information received from any of these sources is referred to as a hotline contact. The OIG hotline program is administered by the OIG Office Manager, under the direction of the Director of Investigations. The majority of hotline contacts are from consumers seeking help with problems encountered within their respective credit unions. These contacts are referred to OCP and/or the appropriate NCUA regional office. During this reporting period, the hotline received the following:



Phone contacts / Voicemail	90
Email / Facsimile	220
<u>Written correspondence</u>	<u>29</u>
<b>Total:</b>	<b>339</b>



## INVESTIGATIONS

### Employee Misconduct / Possible Abuse of Authority

During this reporting period, the OIG received an allegation that an employee may have abused his authority in conducting a credit union examination. The investigation found that a miscommunication between the employee and his immediate supervisor resulted in a lower examination rating, which the credit union perceived as retaliatory. The investigation found that prior to the OIG receiving the case, the miscommunication was resolved and the original rating was restored. The OIG issued a Report of Investigation summarizing the investigation and closed this case.

### Unauthorized disclosure of confidential information

During this reporting period, the OIG was asked to look into the possibility that an NCUA employee may have disclosed a credit union CAMEL rating to the media. The investigation determined that no NCUA employee was involved in the disclosure. Rather, the investigation found that a credit union official was the likely source of the disclosure, in an effort to discredit a potential nominee for an NCUA Board member appointment. The Report of Investigation aided NCUA in its investigation of the matter. On March 28, 2012, the NCUA issued an order prohibiting James M. Talbert from participating in the affairs of any federally insured credit union. The Prohibition Order cited Mr. Talbert for breaching his fiduciary duties in connection with his position at DC FCU by unlawfully disclosing non-public information. The OIG issued a Report of Investigation summarizing the investigation and closed this case.

### Employee Misconduct / Possible Time and Attendance Fraud and Conflict of Interest

During the reporting period, the OIG received an allegation that an NCUA employee improperly used sick leave to fulfill instructional assignments for an outside employer. Additionally, the employee was alleged to have used materials he prepared as part of his official NCUA duties in his outside instructional assignments. The investigation revealed that the employee did in fact use some of his sick leave hours to fulfill his outside instructional assignments; however, the investigation found that he did not use materials prepared as part of his official duties for outside teaching.

### Employee Misconduct / False Statements

During this reporting period, the OIG received allegations that a senior NCUA employee made false statements with regard to a state chartered credit union and the state regulator's office. This investigation is ongoing.

**PEER REVIEWS****OCTOBER 1, 2011 THROUGH MARCH 31, 2012**

Section 6(e)(7) of the Inspector General Act of 1978, as amended, requires those OIGs that have been granted statutory law enforcement authority pursuant to the Act, to be periodically reviewed by another OIG or a committee of OIGs (Peer Review). The purpose of the peer review is to ascertain whether adequate internal safeguards and management procedures exist to ensure that the law enforcement powers conferred by the 2002 amendments to the Act are properly exercised. The NCUA OIG does not have statutory law enforcement authority; therefore, our investigative organization is not required to have a peer review and, to date has neither undergone a peer review nor conducted a peer review of another OIG. However, the NCUA Office of Investigations is slated to conduct its first peer review the third quarter of 2012 and is scheduled for its peer review the third quarter 2013.

## LEGISLATIVE AND REGULATORY REVIEWS

Section 4(a) of the Inspector General Act requires the Inspector General to review existing and proposed legislation and regulations relating to the programs and operations of the NCUA and to make recommendations concerning their impact. Moreover, we routinely review proposed agency instructions and other policy guidance, in order to make recommendations concerning economy and efficiency in the administration of NCUA programs and operations and the prevention and detection of fraud, waste and abuse.

During the reporting period, the OIG reviewed 21 items, including proposed legislation, proposed and final regulations, Advanced Notice of Proposed Rulemakings (ANPR), and NCUA Letters to Credit Unions. The OIG also responded to seven (7) Freedom of Information Act requests.

<b>SUMMARY OF STATUTES AND REGULATIONS REVIEWED</b>	
<b>Legislation</b>	<b>Title</b>
S. 2231	“Small Business Lending Enhancement Act”
H.R. 3461	“Financial Institutions Examination Fairness and Consumer Credit Reform Act”
S. 2105	“Cybersecurity Act of 2012”
H.R. 4014/S. 2099	“To Amend the Federal Deposit Insurance Act with Respect to Information Provided to the Consumer Financial Protection Bureau”
H.R. 2572	“Clean Up Government Act of 2011”
<b>Regulations/Rulings/IRPS</b>	<b>Title</b>
12 CFR Parts 701, 760 and 790	Technical Amendments (Final Action)
12 CFR Part 741	Interest Rate Risk Policy and Program (Final Action)
12 CFR Part 701	Technical Amendments to Section 701.34 (Final Action)
12 CFR Part 704	Corporate Credit Unions (Final Action)
12 CFR Part 750	Golden Parachute and Indemnification Payments; Technical Correction (Final Action)
12 CFR Part 701	Remittance Transfers (Final Action)
12 CFR Part 701, 705 and 741	Community Development Revolving Loan Fund for Credit Unions (Final Action)
12 CFR Part 703	Financial Derivatives Transactions to Offset Interest Rate Risk; Investment and Deposit Activities (ANPR with comment period)

12 CFR Part 741	Loan Workouts and Nonaccrual Policy, and Regulatory Reporting of Troubled Debt Restructured Loans (Proposed Rule with Request for Comments)
12 CFR Parts 701, 703, 723	Eligible Obligations, Charitable Contributions, Nonmember Deposits, Fixed Assets, Investments, Member Business Loans, and Regulatory Flexibility Program (Proposed Rule with Request for Comments)
12 CFR Parts 701 and 741	Maintaining Access to Emergency Liquidity (ANPR with comment period)
12 CFR Parts 701 and 741	Loan Participations; Purchase, Sale and Pledge of Eligible Obligations; Purchase of Assets and Assumption of Liabilities (Proposed Rule with Request for Comments)
12 CFR Part 760	Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance (Notice and Request for Comments)

<b>Letters to Credit Unions</b>	<b>Title</b>
11-1211	Separation and Release Agreement (01/20/12)
11-0903	40-Year Real Estate Loan Modifications (02/10/12)
11-0904	Credit Union Service Organization (CUSO) Trustee Activity (11/17/11)

<b>TABLE I: INSPECTOR GENERAL ISSUED REPORTS WITH QUESTIONED COSTS</b>				
		Number of Reports	Questioned Costs	Unsupported Costs
A.	For which no management decision had been made by the start of the reporting period.	0	\$0	\$0
B.	Which were issued during the reporting period.	0	0	0
	Subtotals (A + B)	0	0	
C.	For which management decision was made during the reporting period.	0	0	0
	(i) Dollar value of disallowed costs	0	0	0
	(ii) Dollar value of costs not allowed	0	0	0
D.	For which no management decision has been made by the end of the reporting period.	0	0	0
E.	Reports for which no management decision was made within six months of issuance.	0	0	0

Questioned costs are those costs the OIG has questioned because of alleged violations of laws, regulations, contracts, or other agreements; findings which at the time of the audit are not supported by adequate documentation; or the expenditure for the intended purpose is unnecessary or unreasonable.

Unsupported costs (included in "Questioned Costs") are those costs the OIG has questioned because of the lack of adequate documentation at the time of the audit.

<b>TABLE II: INSPECTOR GENERAL ISSUED REPORTS WITH RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE</b>			
		Number of Reports	Dollar Value
A.	For which no management decision had been made by the start of the reporting period.	0	\$0
B.	Which were issued during the reporting period.	0	0
Subtotals (A + B)		0	0
C.	For which management decision was made during the reporting period.	0	0
	(i) Dollar value of recommendations agreed to by management.	N/A	N/A
	(ii) Dollar value of recommendations not agreed to by management.	N/A	N/A
D.	For which no management decision was made by the end of the reporting period.	0	0
E.	For which no management decision was made within six months of issuance.	0	0

Recommendations that "Funds to be Put to Better Use" are those OIG recommendations that funds could be used more efficiently if management took actions to reduce outlays, de-obligate funds from programs/operations, avoid unnecessary expenditures noted in pre-award reviews of contracts, or any other specifically identified savings.

**TABLE III: SUMMARY OF OIG ACTIVITY  
October 1, 2011 through March 31, 2012**

**PART I – AUDIT REPORTS ISSUED**

<b>Report Number</b>	<b>Title</b>	<b>Date Issued</b>
OIG-11-12	Independent Evaluation of the NCUA’s Compliance with the Federal Information Security Management Act (FISMA) 2011	11/10/2011
OIG-11-13	NCUA Financial Statements Audit 2010 (TCCUSF)	12/27/2011
OIG-12-01/02/03/04	NCUA Financial Statements Audit 2010 (OF, CLF, CDRLF, SIF)	02/16/2012
OIG-12-05	Material Loss Review of Vensure FCU	02/29/2012
OIG-12-06	Audit of the NCUA’s Asset Management and Assistance Center (AMAC)	03/19/2012

**PART II – AUDITS IN PROGRESS** *(as of March 31, 2012)*

NCUA Financial Statements Audit 2011 (TCCUSF)
Material Loss Review of O.U.R. FCU
Review of NCUA’s Controls over Sensitive and Proprietary Information
Review of NCUA’s Examination Process for Small Credit Unions
Review of NCUA’s Red Flag Reports

<b>INDEX OF REPORTING REQUIREMENTS</b>		
<b>Section</b>	<b>Data Required</b>	<b>Page Ref</b>
4(a)(2)	Review of legislation and regulations	23
5(a)(1)	Significant problems, abuses, or deficiencies relating to the administration of programs and operations disclosed during the reporting period.	11
5(a)(3)	Recommendations with respect to significant problems, abuses or deficiencies	11
5(a)(3)	Significant recommendations described in previous semiannual reports on which corrective action has not been completed.	15
5(a)(4)	Summary of matters referred to prosecution authorities and prosecutions which have resulted.	None
5(a)(5)	Summary of each report to the Board detailing cases where access to all records was not provided or where information was refused.	None
5(a)(6)	List of audit reports issued during the reporting period.	27
5(a)(7)	Summary of particularly significant reports.	11
5(a)(8)	Statistical tables on audit reports with questioned costs.	25
5(a)(9)	Statistical tables on audit reports with recommendations that funds be put to better use.	26
5(a)(10)	Summary of each audit report issued before the start of the reporting period for which no management decision has been made by the end of the reporting period.	None
5(a)(11)	Description and explanation of reasons for any significant revised management decision made during the reporting period.	None
5(a)(12)	Information concerning significant management decisions with which the Inspector General is in disagreement.	None
5(a)(14)	An appendix containing the results of any peer review conducted by another OIG during the reporting period or, if no peer review was conducted within that reporting period, a statement identifying the date of the last peer review conducted by another OIG.	19
5(a)(15)	List of outstanding recommendations from any peer review conducted by another OIG that have not been fully implemented.	None
5(a)(16)	A list of any peer reviews conducted by the IG of another OIG during the reporting period, including a list of any outstanding recommendations made that remain outstanding or have not been fully implemented.	19



**APPENDIX A: NCUA SYSTEM REVIEW REPORT (SEC OIG REPORT NO. 478)**



U.S. Securities and Exchange Commission  
Office of Inspector General  
Office of Audits

**National Credit Union Administration  
System Review Report**



May 7, 2010  
Report No. 478

## System Review Report

May 7, 2010

William DeSarno  
Inspector General  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

Dear Mr. DeSarno,

We have reviewed the system of quality control for the audit organization of the National Credit Union Administration (NCUA), Office of Inspector General (OIG) in effect for the period ended October 30, 2009. A system of quality control encompasses NCUA OIG's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of conforming with *Government Auditing Standards*. The elements of quality control are described in the *Government Auditing Standards*. NCUA OIG is responsible for designing a system of quality control and complying with it to provide NCUA OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and NCUA OIG's compliance therewith based on our review.

Our review was conducted in accordance with *Government Auditing Standards* and guidelines established by the Council of the Inspectors General on Integrity and Efficiency (CIGIE). During our review, we interviewed NCUA OIG personnel and obtained an understanding of the nature of the NCUA OIG audit organization, and the design of the NCUA OIG's system of quality control sufficient to assess the risks implicit in its audit function. Based on our assessments, we selected engagements and administrative files to test for conformity with professional standards and compliance with NCUA OIG's system of quality control. The engagements selected represented a reasonable cross-section of the NCUA OIG's audit organization, with emphasis on higher-risk engagements. Prior to concluding the review, we reassessed the adequacy of the scope of the peer review procedures and met with NCUA OIG's management to discuss the results of our review. We believe that the procedures we performed provide a reasonable basis for our opinion.

In performing our review, we obtained an understanding of the system of quality control for NCUA OIG's audit organization. In addition, we tested compliance with NCUA OIG's quality control policies and procedures to the extent we considered appropriate. These tests covered the application of NCUA OIG's policies and procedures on selected engagements. Our review was based on selected tests;

therefore, it would not necessarily detect all weaknesses in the system of quality control or all instances of noncompliance with it.

There are inherent limitations in the effectiveness of any system of quality control, and therefore noncompliance with the system of quality control may occur and not be detected. Projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate.

Enclosure 1 to this report identifies the audit engagements that we reviewed.

In our opinion, the system of quality control for the audit organization of NCUA OIG in effect for the period ended October 30, 2009 has been suitably designed and complied with to provide NCUA OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Federal audit organizations can receive a rating of *pass*; *pass with deficiencies*, or *fail*. The NCUA OIG has received a peer review rating of *pass*. As is customary, we issued a letter dated May 7, 2010, that sets forth findings that were not considered to be of sufficient significance to affect our opinion expressed in this report.

In addition to reviewing its system of quality control to ensure adherence with *Government Auditing Standards*, we applied certain limited procedures in accordance with guidance established by the CIGIE related to NCUA OIG's monitoring of engagements performed by Independent Public Accountants (IPA) under contract where the IPA served as the principal auditor. It should be noted that monitoring of engagements performed by IPAs is not an audit and therefore is not subject to the requirements of *Government Auditing Standards*. The purpose of our limited procedures was to determine whether NCUA OIG had controls to ensure IPAs performed contracted work in accordance with professional standards. However, our objective was not to express an opinion and accordingly, we do not express an opinion, on NCUA OIG's monitoring of work performed by IPAs.

Sincerely,



H. David Kotz  
Inspector General

Enclosures (2)



**Enclosure 1**

**SCOPE AND METHODOLOGY**

We tested compliance with the NCUA OIG audit organization’s system of quality control to the extent we considered appropriate. These tests included a review of 1 of 2 audit reports issued during the period April 1, 2008, through October 30, 2009. We also reviewed the internal quality control review performed by NCUA OIG.

In addition, we reviewed the NCUA OIG’s monitoring of an engagement performed by an IPA, where the IPA served as the principal auditor. NCUA OIG contracted for the audit of its agency’s Fiscal Year 2008 Financial Statements. Due to problems related to a major accounting issue that has not been resolved, the financial statement audit has not been completed and a final report has not been issued. We reviewed this audit to determine whether it was adequately monitored.

**Reviewed Engagements Performed by NCUA OIG**

<u>Report No.</u>	<u>Report Date</u>	<u>Report Title</u>
OIG-09-03	Oct 23, 2009	Material Loss Review – New London Security Federal Credit Union
OIG-08-06	June 4, 2008	Review of the Implementation of Homeland Security Presidential Directive 12

**Reviewed Monitoring Files of NCUA OIG for Contracted Engagements**

<u>Report No.</u>	<u>Report Date</u>	<u>Report Title</u>
Pending	Pending	NCUA Financial Statements

Enclosure 2



National Credit Union Administration

Office of Inspector General

The Honorable H. David Kotz  
Inspector General  
Office of the Inspector General  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Date: April 22, 2010

Subject: Report on the External Quality Control Review of the National Credit Union Administration Inspector General Audit Organization

Dear Mr. Kotz

We appreciate the work conducted by your staff in reviewing the quality control process for the audit function at the National Credit Union Administration (NCUA) OIG. We agree with your opinion that the system of quality control for the audit function meets the requirements established by the Comptroller General of the United States for a General Government audit organization. We have no additional comments on the final System Review draft report provided. Thank you for the professionalism shown and your efforts in completing this review.

Sincerely,

A handwritten signature in black ink, appearing to read 'William A. DeSarno'.

William A. DeSarno  
Inspector General

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1775 Duke Street • Alexandria, Virginia 22314-3428 • 703-518-6350 • 703-518-6349 FAX • oigmail@ncua.gov