

**NATIONAL CREDIT UNION ADMINISTRATION
OFFICE OF INSPECTOR GENERAL**

SEMIANNUAL REPORT
TO
THE CONGRESS

April 1, 2010 – September 30, 2010



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INSPECTOR GENERAL'S MESSAGE

TO THE NCUA BOARD AND THE CONGRESS

I am pleased to provide this semiannual report on the activities and accomplishments of the National Credit Union Administration (NCUA) Office of Inspector General (OIG) from April 1, 2010, to September 30, 2010. During this reporting period, the OIG's enormous workload challenges persisted, mirroring challenges at the NCUA and within the credit union industry overall. In addition, with the signing by President Obama of the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the Act) on July 21, 2010, the federal financial regulators, including NCUA, are occupied with implementing sweeping changes to the structure, regulation, and oversight of federal financial institutions. The Act also includes provisions that strengthen the independence of Inspectors General.

Of immediate impact to the NCUA OIG, the Act amends section 216(j) of the Federal Credit Union Act (12 U.S.C. 1790d(j)), by increasing the material loss threshold—representing the loss to the National Credit Union Share Insurance Fund (NCUSIF) -- from \$10 million to \$25 million. Once the threshold loss amount is triggered, the OIG must conduct a material loss review (MLR) and issue a report. In these MLRs, we determine the causes of the credit union's loss to the NCUSIF and assess the NCUA's supervision of the credit union. The Dodd-Frank Act also requires some level of review for losses that do not reach the materiality threshold. Specifically, for losses to the NCUSIF that are not material, the Act requires my office to determine (1) the grounds for appointing the NCUA Board as the liquidating agent or for the NCUA Board to initiate assistance; and (2) whether any circumstances exist that might warrant an in-depth review of the loss—regardless of the loss amount. With regard to these "non-material" losses, the new law also requires my office to prepare a written report, every six months, to the Board and the Congress on the results of our determinations.

The OIG has worked extensively during this reporting period on conducting and reporting MLRs of natural person credit unions and, significantly, two corporate credit unions which the NCUA placed under federal conservatorship in 2009: U.S. Central Federal Credit Union (U.S. Central) of Lenexa, Kansas, and Western Corporate Federal Credit Union (WesCorp) of San Dimas, California. The MLR work on both corporates has been completed and we intend to issue the final reports in early October. Concurrently, on September 24, 2010, NCUA announced its plan to assume control of three additional corporate credit unions, isolate the impaired assets in the corporate credit union system, and finalize a set of stronger regulations which require higher capital standards, lower concentration risks, sound asset/liability management strategies, and transparent governance for all corporate credit unions. We

anticipate that the agency's implementation of the new regulatory framework for corporate credit unions will go far in addressing the deficiencies we noted during our MLR work on U.S. Central and WesCorp, respectively.

On the investigative side, a year-long investigation into a case involving alleged loan fraud on the part of a senior employee led the OIG to identify shortcomings in the agency's process for ensuring that NCUA employees' security clearances are updated in a timely manner, as well as its program for reviewing employees' Office of Government Ethics Confidential Financial Disclosure Reports. We intend to follow up with proactive reviews of both programs as OIG resources permit.

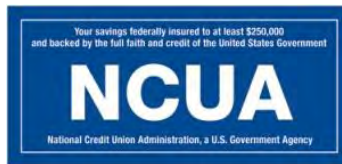
I am very proud of the accomplishments and commitment of our very small staff during the past six months. Indeed, over the past two years we have experienced unprecedented workload demands, and the OIG staff has consistently risen to the challenges presented with exceptional dedication and a positive attitude. The work of my staff has been critical in providing the NCUA, the United States Congress, and the public with valuable information about the safety and soundness of the credit union system. We look forward to continuing to provide that same high level of service and work product in the future.



William A. DeSarno
Inspector General

THE NCUA MISSION

NCUA's charge is to facilitate the availability of credit union services to all eligible consumers, especially those of modest means, through a regulatory environment that fosters a safe and sound credit union system.



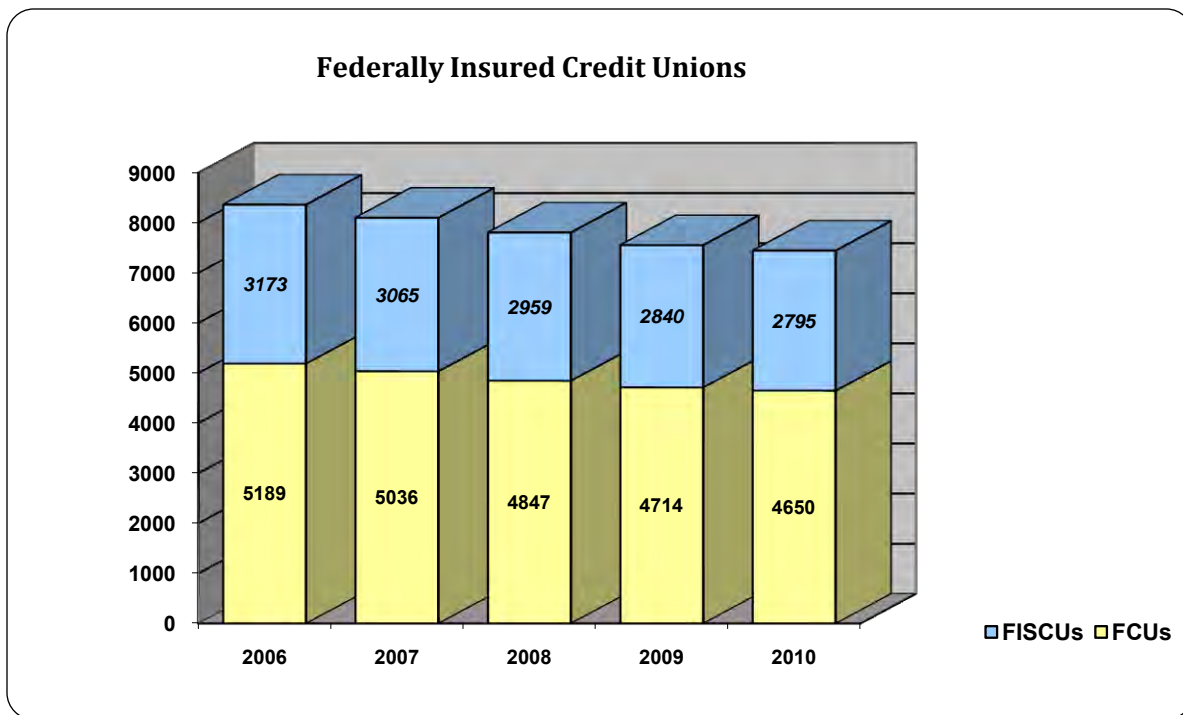
THE OFFICE OF INSPECTOR GENERAL MISSION

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.

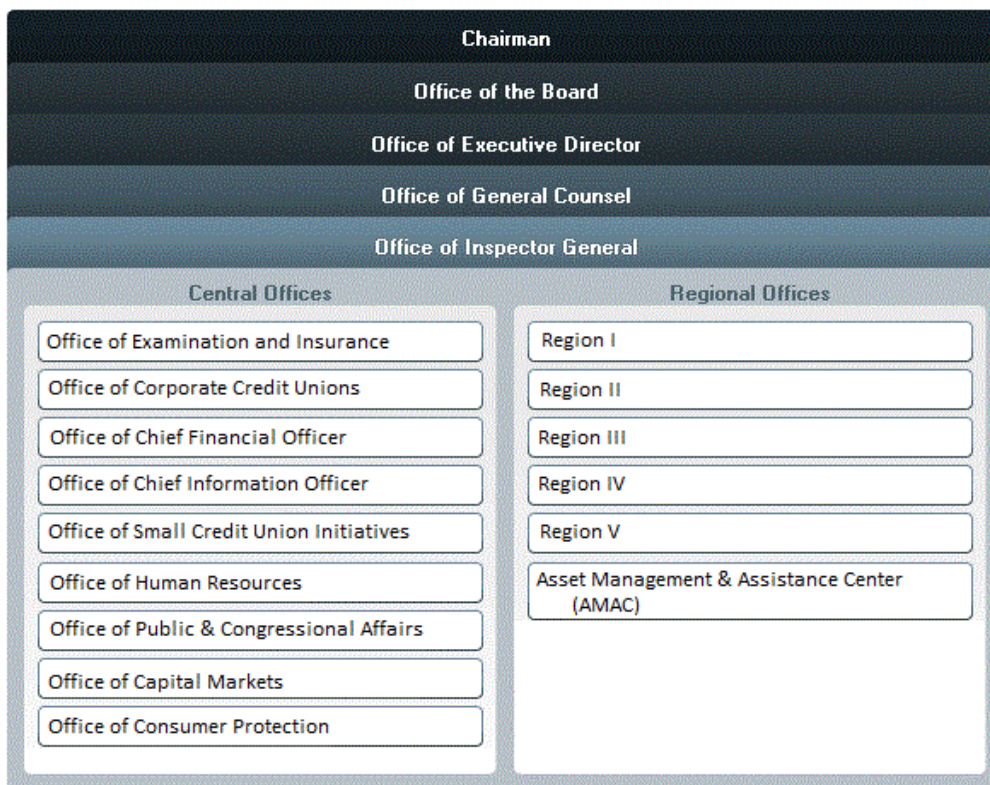
INTRODUCTION

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 June 30, 2010, the NCUA was supervising and insuring 4,650 federal credit unions and insuring 2,795 state-chartered credit unions, a total of 7,445 institutions. This represents a decline of 64 federal and 45 state-chartered institutions since December 31, 2009, for a total decline of 109 credit unions nationwide, primarily as a result of liquidations.

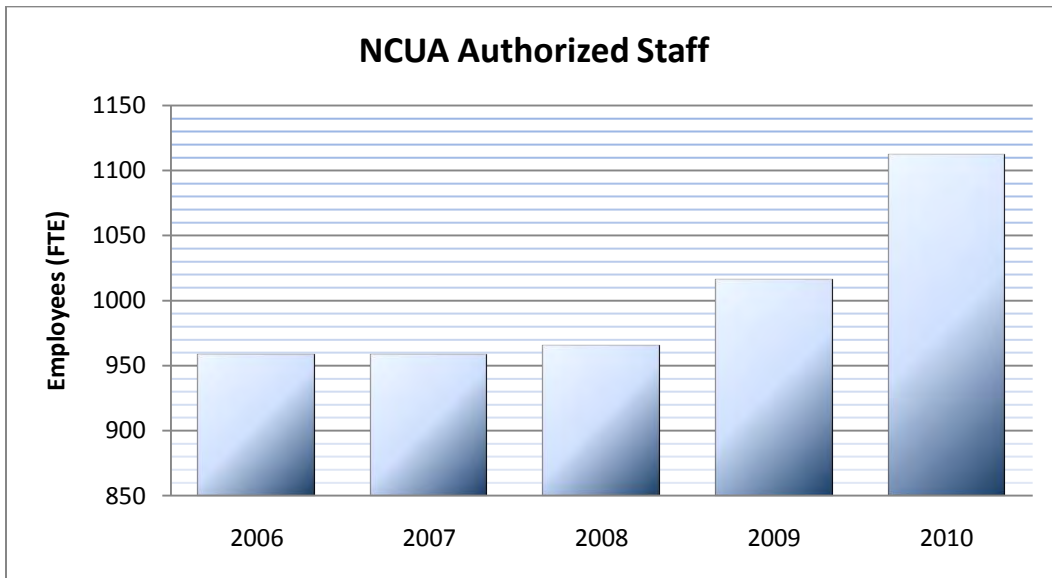
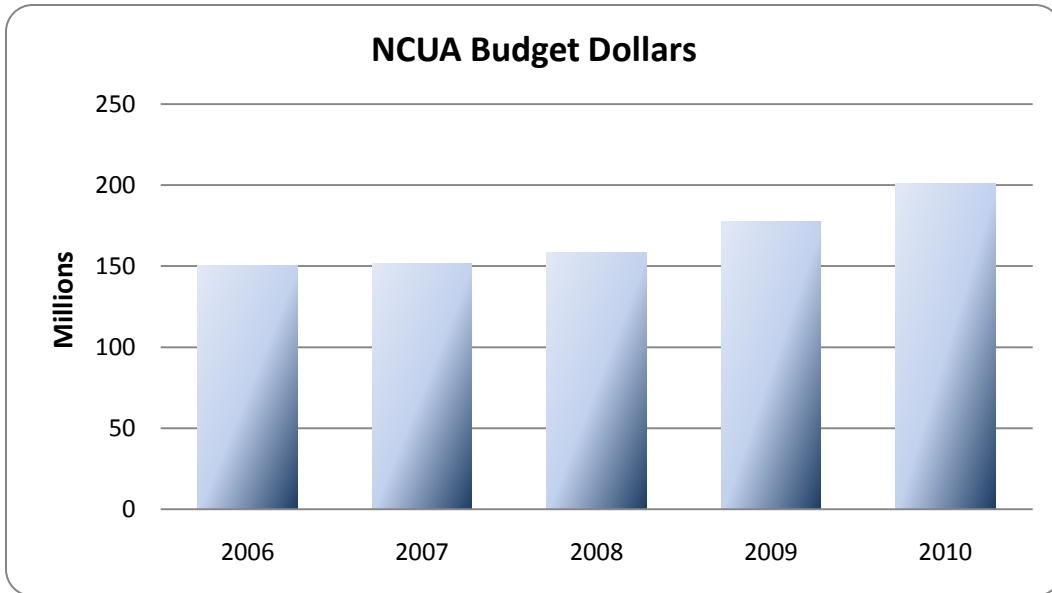


The NCUA operates under the direction of a Board composed of three members. Board members are appointed by the President and confirmed by the Senate. They serve six-year terms. Terms are staggered, so that one term expires every two years. The Board is responsible for the management of the NCUA, including 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 2010 budget of \$200,923,512 on November 19, 2009. The Full-Time Equivalent (FTE) staffing authorization for 2010 is 1,112 representing an increase of 74 FTEs from 2009.



NCUA HIGHLIGHTS

NCUA Adopts Reforms for Corporate Credit Union System

In an open board meeting on September 24, 2010, the NCUA Board announced that it was assuming control of three undercapitalized corporate credit unions, articulated a plan to isolate the impaired assets in the corporate credit union system, and finalized a set of stronger regulations—key elements in its efforts to resolve the financial challenges facing corporate credit unions without disrupting consumer service. NCUA stated that the Temporary Corporate Credit Union Share Guarantee Program will remain fully in effect for the entire corporate system through December 31, 2010. In addition, NCUA will continue to insure credit union and consumer deposits up to \$250,000 per account.

At the September 24 meeting, the NCUA Board announced that setting its plan into motion required conservatorship of three additional corporate credit unions: Members United Corporate Federal Credit Union of Warrenville, Illinois; Southwest Corporate Federal Credit Union of Plano, Texas; and Constitution Corporate Federal Credit Union of Wallingford, Connecticut. In 2009, NCUA placed U.S. Central Federal Credit Union of Lenexa, Kansas, and Western Corporate Federal Credit Union of San Dimas, California, into conservatorship. In a conservatorship, NCUA replaces an institution's management and board, operating in a way that protects taxpayers' and members' interests during its orderly transition and resolution.

The agency's plan to address the impaired assets and resolve the five troubled institutions involves several interrelated steps:

- Isolating the impaired securities (legacy assets) held by these five corporate credit unions;
- Repackaging the legacy assets into new securities with an NCUA guarantee backed by the unconditional full faith and credit of the United States government;
- Issuing the new securities to investors on the open market;
- Transferring the corporates' still-valuable assets to newly created "bridge corporate credit unions" that will allow for continued operations; and
- Transitioning operations now under NCUA conservatorship over a target of 24 months to other service providers.

NCUA consulted with the Treasury, Federal Reserve, and other federal financial regulators in developing these plans, and Board members stated the NCUA's intent to work closely with these other agencies to ensure the orderly resolution of conserved corporates, the effective implementation of the steps outlined, and the continued smooth operation of the credit union system.

With the concurrence of Treasury Secretary Timothy F. Geithner, the Temporary Corporate Credit Union Stabilization Fund (TCCUSF) was extended to June 30, 2021. This will provide the NCUA Board with flexibility in mitigating the impact of the annual assessments to credit unions for the costs over this period. The Board emphasized that the costs involved will be borne exclusively by the credit union industry, and will not result in any loss to taxpayers.

NCUA also adopted a new set of regulatory reforms aimed at strengthening the corporate credit union system. The new corporate regulation (NCUA Rules and Regulations, Part 704):

- Implements stronger capital requirements and establishes prompt corrective action measures for corporate credit unions;

- Establishes clear concentration limits on investments that will require corporate credit unions to better diversify their portfolios;
- Improves asset-liability management requirements to avoid liquidity and interest rate risks; and
- Raises governance standards to improve levels of experience and expertise on corporate boards.

NCUA Board Adopts Federal Accounting Standard for NCUSIF

At its September 24, 2010, Board meeting, the NCUA Board voted to adopt Federal Accounting Standards Advisory Board (FASAB) standards, also known as Federal Accounting Standards, for the National Credit Union Share Insurance Fund (NCUSIF), retroactive to January 1, 2010. The Board action followed a similar June 17, 2010, action that adopted the same accounting standards for the TCCUSF. The Board stated that since the June action, the agency had gained more experience with FASAB standards and concluded that they more appropriately met the financial reporting requirements of the NCUSIF and its stakeholders. FASAB is the preferred method of reporting for federal entities. The American Institute of Certified Public Accountants (AICPA) recognizes FASAB as the board that promulgates generally accepted accounting principles (GAAP) for federal entities. FASAB is responsible for designating GAAP for federal entities.

NCUA Files Amended Complaint for Losses at WesCorp

The NCUA Board, in its role as Conservator of Western Corporate Federal Credit Union (WesCorp), filed an amended complaint on August 31, 2010, with the U.S. District Court for the Central District of California in a pending lawsuit as a result of losses at the conserved corporate credit union. The August 31 filing, which superseded a November 2009 complaint, alleged various breaches of fiduciary duties of care and gross negligence on the part of fifteen former WesCorp directors and officers in connection with over-concentration of certain types of Option ARM Mortgage Backed Securities. The complaint also alleged breaches of fiduciary duty and fraud on the part of two former WesCorp officers and unjust enrichment on the part of one former officer in connection with irregular payments from WesCorp's Supplemental Executive Retention Plans.

The November 2009 suit, which the August 31, 2010, complaint superseded, was filed by a group of seven WesCorp member credit unions against certain current and former directors and officers of WesCorp in a case captioned *1st Valley Credit Union, et al. v. Bland, et al.* NCUA intervened in that lawsuit and removed the case to Federal District Court. On July 15, 2010, the court granted NCUA's motion to substitute the Conservator as proper party plaintiff as to all derivative claims.

NCUA Office of Consumer Protection Takes Shape as Regulators Lay Consumer Bureau Groundwork

During the reporting period, the NCUA Board approved the creation of the Office of Consumer Protection (OCP). OCP will be responsible for all consumer protection and consumer compliance policy, programs, and rulemaking; interagency liaison responsibilities for consumer protection and compliance issues; fair lending examinations; the member assistance call center; and consumer financial literacy programs. The new Office, which will be headed by Kent Buckham as Director, consists of two divisions—Division of Consumer Compliance and Outreach; and Division of Consumer Access.

Concurrently, on July 29, 2010, NCUA Chairman Matz joined Treasury Secretary Timothy Geithner and other federal financial regulators for the initial meeting of an inter-agency working group designed to transfer personnel and functions to the newly-created Consumer Financial Protection Bureau

(CFPB). The meeting was also attended by Federal Reserve Board Chairman Ben Bernanke, Comptroller of the Currency John Dugan, Federal Deposit Insurance Corporation Chair Sheila Bair, Federal Trade Commission Chairman Jon Leibowitz, and Housing and Urban Development Secretary Shaun Donovan. NCUA participation in discussions about operations and staffing of the CFBP will be ongoing.

Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law on July 21, 2010, created the CFPB, within the Board of Governors of the Federal Reserve System, to protect financial consumers. The Bureau will regulate the offering and provision of consumer financial products or services under the federal consumer financial laws, and has greater jurisdictional authority over financial institutions with assets in excess of \$10 billion.

NCUA Financial Reports Receive Clean Audits

On June 14, 2010, the NCUA released financial reports for 2008 and 2009, including audited statements of the national Credit Union Share Insurance Fund (NCUSIF). The audits for 2008 were completed by Deloitte & Touche, LLP, while the audits for 2009 were completed by KPMG, LLP. The NCUSIF received unqualified or “clean” audit opinions for both years. In addition to the NCUSIF, auditors also certified the financial accuracy of three other funds overseen by NCUA: the Operating Fund, the Community Development Revolving Loan Fund; and the Central Liquidity Facility. One month later, on July 26, 2010, the agency released the KPMG audit of the financial statements for the TCCUSF. The TCCUSF also received an unqualified or “clean” audit with no deficiencies noted.

NCUA Budget Reduction will Cut Operating Fees \$2 Million

After a mid-year review found NCUA operations running 8 percent below the agency’s original budget during the first half of 2010, NCUA Chairman Matz announced that the NCUA’s budget was reduced by \$2 million, which is projected to reduce cash needs by \$2 million for 2011 federal credit union operating fees. With total NCUA operating costs for the 12-month period ending December 31, 2010, reduced by \$2 million, NCUA’s annual budget this year is \$198,923,512. Staffing vacancies provided the bulk of unused 2010 funding. Various budget reductions more than offset \$3 million worth of new initiatives, which are slated to support and expand core programs and agency goals.

FEDERALLY INSURED CREDIT UNION HIGHLIGHTS

Credit unions submit quarterly call reports (financial and operational data) to the NCUA. An NCUA staff assessment of the June 30, 2010, quarterly call reports submitted by all federally insured credit unions found that key financial indicators show concern.

Key Financial Indicators Showing Concern

Looking at the June 30, 2010 quarterly statistics for major balance sheet items and key ratios shows the following for the nation's 7,445 federally insured credit unions: assets grew 4.4 percent; net worth to assets ratio decreased from 9.9 to 9.88 percent; the loan to share ratio decreased from 76.07 percent to 72.82 percent. However, the delinquency ratio decreased from 1.83 to 1.73 percent; and credit union return on average assets increased from .18 percent to .41 percent.

Savings Shifting to Money Market Accounts

Total share accounts increased 6.68 percent. Money market shares increased 8.1 percent. Regular shares comprise 27.75 percent of total share accounts; share certificates comprise 28.05 percent; money market shares comprise 21.99 percent; share draft accounts comprise 11.05 percent; and all other share accounts comprise 11.15 percent.

Loans Decreased Slightly

Loan decline of 2.14 percent resulted in a decrease in total loans by \$6.11 billion. Total net loans of \$557 billion comprise 62 percent of credit union assets. First mortgage real estate loans are the largest single asset category with \$219.8 billion accounting for 38.81 percent of all loans. Other real estate loans of \$90.08 billion account for 15.09 percent of all loans. Used car loans of \$99.52 billion were 17.57 percent of all loans, while new car loans amounted to \$68.01 billion or 12.01 percent of total loans. Credit card loans totaled \$34.43 billion or 6.08 percent of total loans and other loans totaled \$54.53 billion for 9.63 percent of total loans.

LEGISLATIVE HIGHLIGHTS

President Obama Signs “Dodd-Frank Wall Street Reform and Consumer Protection Act”

On July 21, 2010, President Obama signed into law the “Dodd-Frank Wall Street Reform and Consumer Protection Act,” a historic piece of legislation that will play a crucial role in preventing future financial crises, helping families save for the future, and growing the nation’s economy. The Act has a number of provisions that pertain specifically to NCUA, including:

- Creates a Financial Stability Oversight Council, a body consisting of the heads of the eight primary Federal financial regulatory agencies, the Director of the CFPB, and an independent presidential appointee. The NCUA Chairman serves as a voting member of the Council, which is charged with monitoring potential systemic risks and maintaining the country’s financial stability.
- Makes \$250,000 the permanent maximum share insurance amount.
- Temporarily authorizes NCUA to fully insure the net amount maintained in non-interest-bearing transaction accounts through December 31, 2010. Share insurance coverage is provided by the NCUA NCUSIF.
- Requires the NCUA, in addition to the Federal Reserve Board, Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the Securities and Exchange Commission, and the Federal Housing Finance Agency, within 9 months of the bill’s enactment, to jointly prescribe regulations or guidelines requiring regulated entities with assets of \$1 billion or more to disclose the structures of all incentive-based compensation arrangements offered by the regulated entities to determine if those arrangements provide excessive compensation or could lead to material financial loss.
- With the Act’s creation of the CFPB, the NCUA is consolidating its in-house consumer protection responsibilities. The CFPB will have one mission: to protect consumers by promoting transparency and consumer choice and preventing abusive and deceptive practices in consumer financial products and services. After extensive consultation between the Treasury, NCUA, and the National Treasury Employees Union, NCUA will transfer its share of employees who work on consumer protection to the independent entity that will be housed within the Federal Reserve.
- Amends section 216(j) of the Federal Credit Union Act (12 U.S.C. 1790d(j)), by increasing the material loss threshold—representing the loss to the NCUSIF -- from \$10 million to \$25 million. Once the threshold loss amount is triggered, the OIG must conduct a material loss review (MLR) and issue a report. The Dodd-Frank Act also requires some level of OIG review and reporting for losses that do not reach the materiality threshold.
- Provides financial institutions with an appeals process requiring the CFPB and agency to issue a joint statement of coordinated supervisory action in an effort to avoid supervision conflicts between the CFPB and a Federal financial regulator when both have a supervisory interest. Where appropriate, NCUA will have a representative on the governing panel hearing such appeals.
- Requires the CFPB and the NCUA (and the other prudential regulators) to issue regulations prohibiting retaliation against any financial institution that initiated an appeal.
- Requires NCUA (and the other Federal banking agencies) to provide guidelines to credit unions regarding the offering of low-cost remittance transfers and no-cost basic consumer accounts, as well as agency services to remittance transfer providers.

- Requires NCUA and other agencies, no later than six months after the date of enactment, to establish an Office of Minority and Women Inclusion that will be responsible for all matters relating to diversity in management, employment, and business activities.

Additionally, the legislation provides for the following mortgage reforms:

- Ensures borrowers' ability to repay loans they are sold.
- Prohibits unfair lending practices.
- Expands consumer protections for high-cost mortgages.
- Establishes penalties for irresponsible lending.
- Requires additional disclosures on adjustable-rate mortgages.

Although the Act focuses primarily on the financial services sector, it also contains two provisions that are relevant to all IGs. First, section 989C amends the "Inspector General Act of 1978, as amended," to require IGs to include their peer review results as an appendix to each semi-annual report. Second, section 1505 requires the Government Accountability Office (GAO) to conduct a study of the relative independence, effectiveness, and expertise of all IGs. The report must also assess how amendments to the IG Act made by Dodd-Frank will impact the independence of each affected agency's OIG. A third provision only affects Designated Federal Entity (DFE) IGs, such as the NCUA IG, that report to a full board or commission. The Act conditions DFE IGs' removal on the written concurrence of a two-thirds majority of the board or commission to which the IG reports.

Improper Payments Act Signed Into Law

On July 22, 2010, President Obama signed the "Improper Payments Elimination Act," into law. The law amends the "Improper Payments Information Act of 2002," by requiring agencies to periodically identify and review all programs and activities susceptible to significant improper payments (as defined in the Act) and to report on actions to reduce or recover improper payments in accordance with guidance to be issued by the Office of Management and Budget (OMB). Under the Act, Inspectors General are responsible for annually determining whether their agencies have complied with seven requirements in the Act and submitting reports with their findings to the head of their agency, the GAO, the Senate Committee on Homeland Security and Government Affairs, and the House Committee on Oversight and Government Reform. A finding by an IG that its agency is not in compliance triggers certain requirements for agency heads. The statute emphasizes the use of recovery audits by agencies and provides that up to five percent of amounts collected through such audits may be made available to IGs to carry out the Act. Additionally, the Act tasks the Council of Inspectors General on Integrity and Efficiency (CIGIE) and the Chief Financial Officers Council to issue a joint report identifying improvements to the legislative and regulatory framework for financial management. For executive branch agencies, the Act supplements an executive order on reducing improper payments that was issued in November 2009. That order, E.O. 13520, directs the OMB to identify Federal programs that are most susceptible to improper payments and to set reduction targets. Agencies must provide their IGs with implementation plans for meeting OMB's reduction targets, and IGs must review the implementation plans and offer recommendations for improvement.

Data Breach Notification Act Placed on Senate Calendar

S. 139, the "Data Breach Notification Act," was reported out of the Senate Judiciary Committee on September 15, 2010, and placed on the Senate Legislative Calendar. The Act, introduced by Senator Dianne Feinstein (D-CA) in January 2009, would require Federal agencies to notify individuals and certain law enforcement agencies of security breaches of personally identifiable information (PII). It

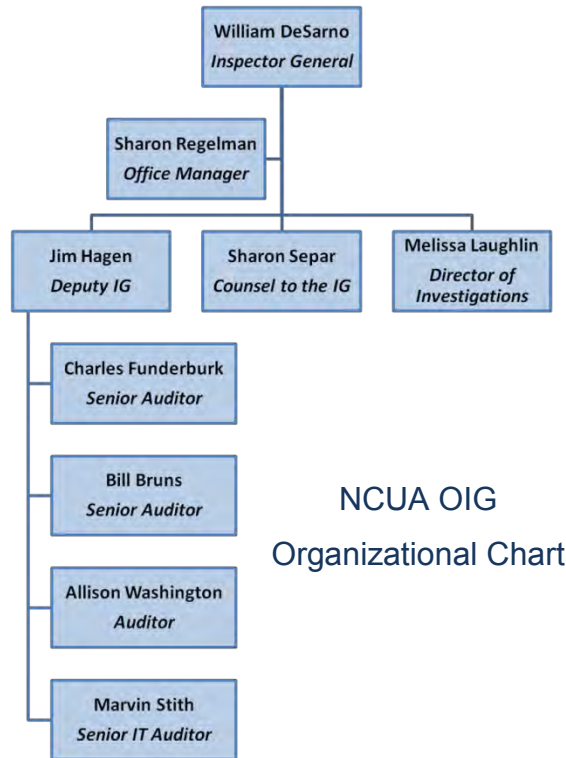
would also supersede any other Federal or State laws concerning notifications of PII security breaches, including a current requirement in the Federal Information Security Management Act (FISMA) that agencies notify their respective IGs in the event of a “security incident.” Despite a letter to the Judiciary Committee sent by the CIGIE proposing reinstatement in the bill of language requiring IG notification for breaches of PII, the bill was reported out of the Judiciary Committee in September without amendment.

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, Auditor, two 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.



AUDIT ACTIVITY

Audit Reports Issued

OIG-10-02 – April 14, 2010

Material Loss Review of Center Valley Federal Credit Union

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) conducted a Material Loss Review of Center Valley Federal Credit Union (Center Valley). We reviewed Center Valley to: (1) determine the cause(s) of failure and the resulting estimated \$16.4 million loss to the National Credit Union Share Insurance Fund (NCUSIF); and (2) assess NCUA's supervision of the credit union. To achieve these objectives, we analyzed NCUA examination and supervision reports and related correspondence; reviewed external auditor work papers; interviewed management and staff from NCUA Region II; and reviewed NCUA guides, policies and procedures, NCUA Call Reports, and NCUA Financial Performance Reports.

We determined embezzlement was the direct cause of Center Valley's failure. During a surprise visit to review Center Valley's call reports and to obtain share and loan balance downloads, NCUA examiners found the chief executive officer (CEO) was keeping two sets of financial records and a \$12.1 million discrepancy existed. Back dated transactions to member accounts were used to conceal the fraudulent activity. On August 3, 2009, a Federal Grand Jury indicted and charged the CEO with embezzling and misapplying \$9 million from Center Valley and money laundering. Consequently, on January 4, 2010, the CEO pled guilty to the charges.

We also determined that credit union management failed to meet their required obligations to implement proper internal controls and oversight. Specifically, management did not ensure (1) member account verifications were properly conducted, (2) adequate internal controls were in place, and (3) controls were monitored for effectiveness. Although Center Valley's Supervisory Committee contracted with external auditors to complete their annual audit, we did not find any evidence of other work performed by the Supervisory Committee. In addition, neither the external auditor nor credit union management resolved a \$252,000 bank reconciliation error. Furthermore, bank reconciliations were several months in arrears, file maintenance reports were not reviewed, and there was a lack of segregation of duties.

Finally, we determined NCUA examiners did not adequately evaluate the risks to Center Valley's operations. Specifically, examiners did not thoroughly evaluate the credit union's internal controls when assessing transaction risk and management component ratings. We found prior to the discovery of the embezzlement NCUA examiners were aware of some internal control weaknesses but did not rate transaction risk as high. As a result, NCUA missed opportunities to expand examination procedures that may have detected the fraud sooner and mitigated the loss to the NCUSIF caused by Center Valley's failure.

*OIG-10-03 – April 14, 2010***Material Loss Review of Cal State 9 Credit Union**

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) conducted a Material Loss Review of Cal State 9 Credit Union (Cal State 9). We reviewed Cal State 9 to: (1) determine the cause(s) of failure and the resulting estimated \$206 million loss to the National Credit Union Share Insurance Fund (NCUSIF); and (2) assess NCUA's supervision of the credit union. To achieve these objectives, we analyzed NCUA examination and supervision reports and related correspondence; reviewed external auditor work papers; interviewed management and staff from NCUA Region II; and reviewed NCUA guides, policies and procedures, NCUA Call Reports, and NCUA Financial Performance Reports.

We determined Cal State 9 failed because its Board and management (management) did not implement adequate risk management practices to address credit, concentration, and liquidity risks. Specifically, management committed an exorbitant percentage of the credit union's assets in an indirect Home Equity Line of Credit (HELOC) program without adequate controls in place to oversee and manage the risks in the program's operations.

A significant factor in Cal State 9's failure was management's strategic decision to fund an excessive amount of indirect HELOCs rife with risky loan elements despite examiners' concerns in the years preceding the institution's failure. California SSA and NCUA examiners determined, and the OIG agrees, that Cal State 9 management:

- Created credit risk through weak underwriting standards.
- Created concentration risks by: (1) allowing the indirect HELOC portfolio to account for a significant percentage of the credit union's total assets, and (2) funding most of the indirect HELOC portfolio with subprime loans.
- Created liquidity risk through their rapid and excessive funding of high risk subprime indirect HELOCs.

We determined that despite examiners' concerns and recommendations for improvement, management's inability to effectively manage the risks their own actions had created eventually led to Cal State 9's failure.

We also determined NCUA and California SSA examiners did not respond adequately or timely to the risks facing Cal State 9, considering: (1) the rate and level of growth of the HELOC portfolio; (2) the excessive concentration of HELOCs, nearly all of which contained subprime elements; and (3) the continuing changes in the California real estate market environment. Finally, we determined examiners did not adequately monitor the credit union's liquidity position. As a result, we believe examiners missed opportunities to slow or stop the growth of the indirect HELOC program, which would have likely mitigated the loss to the NCUSIF.

*OIG-10-04 – May 5, 2010***Material Loss Review of Eastern Financial Florida Credit Union**

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) contracted with Crowe Horwath LLP to conduct a Material Loss Review (MLR) of Eastern Financial Florida Credit Union (Eastern Financial or EFFCU), a federally insured state-chartered credit union (FISCU). The MLR objectives were to (1) determine the cause(s) of EFFCU's failure and the resulting estimated \$40 million loss to the National Credit Union Share Insurance Fund (NCUSIF), and (2) assess supervision of the credit union. To achieve these objectives, we analyzed NCUA and Florida State Supervisory Authority (Florida SSA) examination and supervision reports and related correspondence; interviewed management and staff from NCUA Region III and the Florida SSA; and reviewed NCUA and Florida SSA guides, policies and procedures, NCUA Call Reports, and NCUA Financial Performance Reports (FPRs).

Eastern Financial's management and Board did not practice sound risk management and created an environment of excessive spending, rapid expansion, increased concentration risk, and a flawed overall strategic plan that put increasing pressure on the credit union to produce higher levels of revenue. As EFFCU's profitability lagged its asset growth, the Board and management approved a leverage strategy to make significant investments in CDOs funded by short term borrowings without fully understanding the interest rate and credit risks associated with such complex investments and exposed EFFCU's net worth. Management allowed the CDO investment exposure to represent a significant concentration compared to net worth over a short period of time and failed to impose practical limits in the complex and risky investments. Once the investments deteriorated in value, EFFCU management had no course of action for proper divestiture of the assets, even when the investment grades fell below permissible levels per Florida statutes.

We also determined that had examiners taken stronger supervisory action earlier, EFFCU's Board and management may have been influenced to address their aggressive growth strategy and CDO investment strategy. As a result, the significant level of risk assumed during the institution's rapid growth period may have been lessened, to some extent, which would have mitigated the loss to the NCUSIF.

This report did not make formal recommendations but provided observations and suggestions. Observations made as a result of our review of EFFCU's failure included:

- Examiners and officials did not appear to fully understand the severity of the risks associated with the purchases of CDO investments, nor did it appear that examiners performed further evaluation of CDO investments as required under NCUA guidance. Examiners should have deemed the credit union's CDO investment activity as a higher risk warranting greater supervisory efforts, especially given that the CDOs were not typical investments held by natural person credit unions.
- Eastern Financial's management and Board exposed the credit union to excessive risks by not placing prudent limits on CDO sectors. Reasonable measures would have included lower limits for the CDO sector and further limits on underlying collateral exposure as a percent of net worth.
- NCUA and Florida SSA could have benefited from more active dialogue and more detailed workpapers during the supervision of EFFCU due to its size and complexity. Additional communication should be encouraged or required when credit union's request to purchase complex investments that are not typical of natural person credit unions.

*OIG-10-05/06/07/08 – June 11, 2010***Financial Statements Audit 2008: Operating Fund, Share Insurance Fund, Central Liquidity Facility, and Community Development Revolving Loan Fund**

Our contracting audit firm, Deloitte & Touche LLP, issued opinions on the 2008 financial statements of the National Credit Union Administration Operating Fund, National Credit Union Share Insurance Fund, the Central Liquidity Facility, and the Community Development Revolving Loan Fund. The auditors found that the financial statements presented fairly the financial position of the agency's funds as of December 31, 2008.

The **NCUA Operating Fund (OIG-10-05)** 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 funds total assets for 2008 were \$59.7 million, down from \$60.8 million in 2007.

The **National Credit Union Share Insurance Fund (OIG-10-06)** 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 2008 were \$8.2 billion, up from \$7.5 billion in 2007.

The **Central Liquidity Facility (OIG-10-07)** 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 2008 were \$1.6 billion, down from \$1.7 billion in 2007.

The **Community Development Revolving Loan Fund's (OIG-10-08)** 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 2008 were \$16.2 million, down from \$16.3 million in 2007.

*OIG-10-09/10/11/12 – June 11, 2010***Financial Statements Audit 2009: Operating Fund, Share Insurance Fund, Central Liquidity Facility, and Community Development Revolving Loan Fund**

Our contracting audit firm, KPMG LLP, issued opinions on the 2009 financial statements of the National Credit Union Administration Operating Fund, National Credit Union Share Insurance Fund, the Central Liquidity Facility, and the Community Development Revolving Loan Fund. The auditors found that the financial statements presented fairly the financial position of the agency's funds as of December 31, 2009.

The NCUA Operating Fund (OIG-10-05) 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 funds total assets for 2009 were \$66.0 million, up from \$59.7 million in 2008.

The National Credit Union Share Insurance Fund (OIG-10-06) 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 2009 were \$19.8 billion, up from \$8.2 billion in 2008.

The Central Liquidity Facility (OIG-10-07) 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 2009 were \$20.2 billion, up from \$1.6 billion in 2008.

The Community Development Revolving Loan Fund's (OIG-10-08) 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 2009 were \$17.8 million, up from \$16.2 million in 2008.

*OIG-10-13 – July 22, 2010***Financial Statements Audit 2009: Temporary Corporate Credit Union Stabilization Fund**

Our contracting audit firm, KPMG LLP, issued an opinion on the 2009 financial statements of the National Credit Union Administration Temporary Corporate Credit Union Stabilization Fund (TCCUSF). The auditors found that the financial statements presented fairly the financial position of the agency's funds as of December 31, 2009.

The TCCUSF was created by Public Law 111-22, "Helping Families Save Their Homes Act of 2009," enacted May 20, 2009. The fund was established as a revolving fund in the Treasury of the United States under the management of the Board of Directors of the NCUA. The purposes of the TCCUSF are to accrue the losses of the corporate credit union system, and over time, to assess the credit union system for the recovery of such losses. The auditors issued an **unqualified opinion** on the Fund's financial statements. The TCCUSF's net position was \$(7.0) billion for the period ending December 31, 2009.

*OIG-10-14 – September 22, 2010***Material Loss Review of Clearstar Financial Credit Union**

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) contracted with Moss Adams LLP to conduct a Material Loss Review (MLR) for the Clearstar Financial Credit Union (Clearstar or the Credit Union). We reviewed Clearstar to: (1) determine the cause(s) of the Credit Union's failure and the resulting estimated \$12.2 million loss to the National Credit Union Share Insurance Fund (NCUSIF), (2) assess NCUA's supervision of the Credit Union and, (3) make appropriate recommendations to prevent future losses. To achieve these objectives, we analyzed NCUA and Nevada Department of Business and Industry, Financial Institutions Division (Nevada's State Supervisory Authority) examination and supervision reports and related correspondence, interviewed management and staff from NCUA Regions I & V, and reviewed NCUA guidance. We also reviewed Regions I & V policies and procedures, NCUA 5300 Call Reports, and NCUA Financial Performance Reports (FPR).

We determined Clearstar failed because its Board and management did not implement proper risk management policies and procedures related to credit and concentration risk. Specifically, management originated and funded a significant amount of poorly underwritten loans to many borrowers that had poor credit histories. Because of this, over time, the Credit Union's loan portfolio increased in credit risk.

Additionally, the Credit Union used modified borrower classification matrixes that allowed them to approve loans to borrowers that were of a much higher credit risk than industry standards would expect. Also, in late 2008, management began extending an inordinate number of delinquent loans when it became obvious borrowers did not have the ability to meet their obligations. This was done to stem the flow of collection issues the Credit Union was facing; despite very little evidence borrowers would have the ability to meet their obligations when the extension period expired.

Finally, the Credit Union focused a significantly large portion of its loan portfolio on new and used vehicle loans originated both internally by Credit Union personnel, as well as externally through an indirect loan program. Clearstar's indirect loan program originated loans from new and used auto and recreational vehicle (RV) dealerships. This program, coupled with liberal underwriting policies, enabled the Credit Union to generate a high volume of new loans. As more of these loans were originated, Clearstar's default rate increased as well. When coupled with the economic recession that began in 2008, the Credit Union's failure was largely unavoidable.

This report made one recommendation, as well as numerous observations and suggestions. However, the OIG plans to issue an MLR capping report with recommendations based on issues raised in this report as well as the other nine Material Loss Reviews conducted by the OIG. As resources allow, the OIG may also conduct more in-depth reviews of specific aspects of the NCUA's supervision program and also make recommendations, as warranted.

*OIG-10-15 – September 23, 2010***Material Loss Review of Ensign Federal Credit Union**

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) contracted with Moss Adams LLP to conduct a Material Loss Review (MLR) for the Ensign Federal Credit Union (Ensign or the Credit Union). We reviewed Ensign to: (1) determine the cause(s) of the Credit Union's failure and the resulting estimated \$30 million loss to the National Credit Union Share Insurance Fund (NCUSIF); (2) assess NCUA's supervision of the Credit Union; and (3) make appropriate recommendations to prevent future losses. To achieve these objectives, we analyzed

NCUA examination and supervision reports and related correspondence, interviewed management and staff from NCUA Regions I & V, and reviewed NCUA guidance. We also reviewed Regions I & V policies and procedures, NCUA 5300 Call Reports, and NCUA Financial Performance Reports (FPR).

We determined Ensign failed because its Board of Directors and management did not implement appropriate risk management practices related to concentration and credit risks. Specifically, management adopted a high-risk strategy that allowed concentrations of up to 80 percent of the loan portfolio in loans secured by real estate, making them vulnerable to the steep and rapid decline in Nevada property values.

Additionally, management failed to ensure proper risk mitigation practices were in place at the Credit Union. Management did not have a proper allowance for loan loss methodology, allowed loan-to-value ratios on Home Equity Lines of Credit (HELOC) loans up to 100 percent, and allowed for 40-year terms on mortgages. Management also failed to implement an effective collection program or conduct regular Asset Liability Management (ALM) meetings. Furthermore, management created additional strain on the Credit Union by not formulating an effective business strategy, committing to excessive fixed assets in the form of branch expansion, and failing to control liquidity risk.

NCUA examiners determined, and we agree, that Ensign management 1) practiced poor management and lacked adequate Board oversight; and 2) allowed large concentrations in mortgage loans.

We determined that despite examiners' concerns and recommendations for improvement, management's inability to effectively manage the risks that their own decisions had created eventually led to Ensign's failure.

Examiners followed NCUA guidance with regard to monitoring and frequency of examinations. Although examiners properly identified the significant issues at Ensign, we believe examiners did not sufficiently downgrade the Credit Union in a timely manner. As a result, we believe examiners missed opportunities to mitigate the loss to the NCUSIF.

This report did not contain recommendations, but provided observations and suggestions. However, the OIG plans to issue an MLR capping report with recommendations based on issues raised in this report as well as the other nine Material Loss Reviews conducted by the OIG.

AUDITS IN PROGRESS

NCUA Financial Statements 2010

Our current contracting audit firm, KPMG, is working on the 2010 financial statements of the NCUA Operating Fund, National Credit Union Share Insurance Fund, the Central Liquidity Facility, the Community Development Revolving Loan Fund and the Temporary Corporate Credit Union Stabilization Fund (TCCUSF).

The NCUA Operating Fund 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 National Credit Union Share Insurance Fund 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 CLF 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. And the Community Development Revolving Loan 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 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. We expect to issue our report in February 2011.

Material Loss Reviews of U.S. Central and Western Corporate Federal Credit Unions

The FCU Act requires the NCUA Office of Inspector General (OIG) to conduct a material loss review (MLR) of an insured credit union if the loss exceeds \$25 million and an amount equal to 10 percent of the total assets of the credit union at the time at which the Board initiated assistance or was appointed liquidating agent. In addition, the OIG may perform a material loss review on selected cases that caused a loss of less than \$25,000,000 at the discretion of the Inspector General. (See next section of this semiannual report titled “Report on Credit Union Losses Not Reaching Materiality Level of \$25 Million.”)

NCUA determined that the U.S. Central and Western Corporate credit unions’ portfolios were reasonably likely to sustain credit losses amounting to slightly more than \$1.5 and \$6 billion, respectively. The material loss review objectives were to (1) determine the cause(s) for the conservatorships of these corporate credit unions and the resulting losses to the National Credit Union Share Insurance Fund (NCUSIF), (2) assess supervision of the corporate credit unions, and (3) make appropriate recommendations to prevent future losses. To achieve these objectives, we analyzed NCUA examination and supervision reports and related correspondence; interviewed management and staff from the NCUA Office of Corporate Credit Unions; and reviewed NCUA guides, policies and procedures, NCUA Call Reports, and NCUA Financial Performance Reports (FPRs).

The OIG was notified by NCUA that the losses incurred by these credit unions had exceeded the statutory requirements, triggering a material loss review by the OIG. The scope of these audits will include an analysis of the credit union's transactions and activities to determine the causes of failure and a review of the supervision of the credit union. The review will be performed in accordance with Government Auditing Standards for performance audits. Our objectives are to determine (1) the causes of the credit union's failure and resulting material loss to the share insurance fund; and (2) assess the NCUA's supervision of the institution, including implementation of the Prompt Corrective Action requirements of the FCU Act. Draft reports have been issued on both reviews. We expect to issue the final reports in October 2010.

Material Loss Review of St Paul Croatian Federal Credit Union

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) conducted a Material Loss Review of St. Paul Croatian Federal Credit Union (St. Paul). We reviewed St. Paul to (1) determine the cause(s) of the credit union's failure and the resulting loss to the National Credit Union Share Insurance Fund (NCUSIF); and (2) assess NCUA's supervision of the credit union. To achieve these objectives, we analyzed NCUA examination and supervision reports and related correspondence; interviewed management and staff from NCUA Region III; and reviewed NCUA guidance, policies and procedures, NCUA Call Reports, and Financial Performance Reports. A draft report has been issued to NCUA management for comment. We expect to issue the final report in October 2010.

Independent Evaluation of the NCUA's Compliance with the Federal Information Security Management Act of 2010

The OIG engaged Carson & Associates Inc. 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 Inc. is evaluating NCUA's security program through interviews, documentation reviews, technical configuration reviews, social engineering testing, and sample testing. NCUA is being evaluated against standards and requirements for federal government agencies such as those provided through FISMA, National Institute of Standards and Technology (NIST) Special Publications (SPs), and OMB memoranda. We anticipate issuing the final report in November 2010.

Material Loss Review Capping Report

The purpose of this report is to summarize significant findings from material loss reviews (MLRs) recently issued or in progress by the NCUA Office of Inspector General (OIG). The Federal Credit Union Act (FCU Act) requires the OIG to conduct a MLR of an insured credit union if the loss to the National Credit Union Share Insurance Fund (NCUSIF) exceeds \$25 million and an amount equal to 10 percent of the total assets of the credit union at the time at which the NCUA Board initiated assistance or was appointed liquidating agent. We issued seven MLR reports during the period from November 2008 through May 2010 and currently have three Natural-Person Credit Union MLRs in progress.

The objectives for each of the ten reports were 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. To achieve these objectives, we analyzed NCUA and State Supervisory Authority (SSA) examination and supervision reports and related correspondence; interviewed key management and staff from NCUA Headquarters and Regional offices and the SSAs, as applicable; and reviewed NCUA policies and

procedures, Call Reports, and Financial Performance Reports (FPRs). Based on similarities and trends found in the first ten MLRs completed by the OIG, we will be making recommendations to NCUA management for corrective action. We anticipate issuing the draft report to management in October 2010.

Significant Audit Recommendations on which Corrective Action Has Not Been Completed

As of September 30, 2010, there were no significant audit recommendations on reports issued over six months ago that have not been either fully implemented or are in the process of implementation.

Report On Credit Union Losses Under Materiality Level of \$25 Million

Section 988 of P.L. 111-203, the “Dodd-Frank Wall Street Reform and Consumer Protection Act” did two things relative to material loss reviews (MLR) of failed credit unions.

First, the threshold for a mandated material loss review was raised to \$25 million or greater loss to the National Credit Union Share Insurance Fund (NCUSIF or SIF) 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 under the threshold to assess whether an in-depth review (consistent with the scope of a material loss review) is warranted and (2) report to the National Credit Union Administration 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 first report on losses not reaching \$25 million covers a one year period from October 1, 2009 to September 30, 2010. Hereafter, we will report every six months in the OIG’s semiannual report.

For all losses to the SIF 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 27 failed credit unions that incurred losses to the SIF under \$25 million that occurred between October 1, 2009 and September 30, 2010. Based on those limited reviews, we determined that one of those losses (Certified Federal Credit Union) warrants additional work. We plan to proceed with a MLR on that institution. We intend to begin work on that MLR by November 1, 2010, and complete it by April 30, 2011. For the 26 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 27 credit union losses to the NCUSIF of less than \$25 million. It provides details on the credit union, estimated loss to the SIF, grounds for conservatorship or merger, cause of the failure if one occurred, supervision, other factors, and our decision to proceed or not with an MLR of the credit union.

DECISIONS REGARDING LOSSES LESS THAN \$25 MILLION

Decision*	Credit Union	Region	Date of Failure	Est. Loss to SIF	Grounds for the NCUA Appointment
Terminate	South End Mutual Benefit Assn CU	1	4/8/2010	\$429k	High loan delinquency; Poor loan underwriting
Terminate	Convent FCU	1	5/17/2010	\$14k	Weak management; Poor recordkeeping
Terminate	Bethel GT FCU	1	4/30/2010	\$23k	Loan delinquency; High operating expenses; Weak management
Terminate	Lawrence Cty School Empl	2	3/5/2010	\$2.3m	Alleged fraud by manager
Terminate	Fairfield Cty OH Fed Emp FCU	3	11/30/2009	\$1.4m	Alleged fraud by manager; Poor lending decisions
Terminate	Friendship Comm FCU	3	2/25/2010	\$354k	Excessive loan delinquency; Loan losses from suspected fraud in 2006
Terminate	Coastal Waters FCU	3	1/1/2010	\$1m	Poor loan underwriting; Inadequate loan collections
Terminate	Bestwall Brunswick FCU	3	2/2/2010	\$13k	Loss of sponsor due to plant closing; Increased loan losses
Terminate	Community Choice FCU	3	3/1/2010	\$226k	High loan losses; High operating expenses; Ineffective management
Terminate	AL Bratcher FCU	3	4/30/2010	\$150k	Alleged fraud by manager; Large loan losses; High operating expenses
Terminate	Liberty Alliance FCU	3	5/1/2010	\$650k	Weak management; High operating expenses; Loan delinquency
Terminate	First Delta FCU	3	6/30/2010	\$1m	Ineffective and incompetent management
Terminate	Industries Puerto Rico	3	9/13/2010	\$995k	Loss of sponsor due to plant closing; High loan delinquency
Terminate	Allied Tube Employees FCU	4	12/31/2009	\$493k	Critically undercapitalized; alleged fraud by the manager
Terminate	Orange County Employees CU	4	6/9/2010	\$1.4m	Alleged fraud by manager; significantly undercapitalized.
Terminate	Kappa Alpha Psi FCU	4	7/30/2010	\$134k	Minimally capitalized; Poor management practices
Proceed	Certified FCU	4	7/31/2010	\$9.2m	Critically Undercapitalized (insolvent); suspected fraud by CEO.
Terminate	First Service CU	4	12/17/2009	\$3.7m	Undercapitalized due to poor management/lending practices. Auto loan fraud
Terminate	GCM FCU	4	12/31/2009	\$200k	Critically undercapitalized due to poor management.
Terminate	First American CU	4	8/31/2009	\$10m	Significantly Undercapitalized; inadequate commercial loan underwriting and poor portfolio management practices.

Decision*	Credit Union	Region	Date of Failure	Est. Loss to SIF	Grounds for the NCUA Appointment
Terminate	Phillips County Self-Help FCU	4	1/6/2010	\$67k	Poor management practices; insolvent
Terminate	Second Baptist Church CU	5	10/1/2009	\$316k	Insolvent ; alleged fraud by the previous manager
Terminate	Heritage West FCU	5	12/31/2009	\$545k	Significantly undercapitalized; poor management
Terminate	Kern Central CU	5	1/8/2010	\$5.6m	Poor management practices; significantly undercapitalized
Terminate	Mutual Diversified Employees FCU	5	2/26/2010	\$2m	Insolvent; alleged fraud by manager
Terminate	Tracy FCU	5	4/27/2010	\$965k	Insolvent due to poor management practices.
Terminate	Norbel CU	5	7/29/2010	\$3.5m	Severely undercapitalize, operating in an unsafe and unsound manner. Fraud by MBL officer

*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

April 1, 2010, through September 30, 2010.

Audit organizations that perform audits and attestation engagements of federal government programs and operations are required by *Government Auditing Standards* to undergo an external peer review every three years. The objective of an external peer review is to determine whether, during the period under review, the audit organization's system of quality control was suitably designed and whether the audit organization was complying with its quality control system in order to provide the audit organization with reasonable assurance of conforming to applicable professional standards.

External Peer Review of NCUA OIG Office of Audit

The U.S. Securities and Exchange Commission (SEC) OIG Office of Audits completed its external peer review of the NCUA OIG Office of Audit for the three-year period ended October 31, 2009. The SEC OIG issued its "NCUA System Review Report" on May 7, 2010. A copy of the report is included herein as Appendix A. In its report, the SEC OIG rendered the opinion that the system of quality control for the NCUA OIG audit organization was suitably designed and complied with, to provide the NCUA OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Therefore, the NCUA OIG received a peer rating of pass. There are no outstanding recommendations from this external peer review.

External Peer Review of National Science Foundation OIG Office of Audit

The NCUA OIG did not conduct a peer review of another audit organization during this reporting period. However, on February 5, 2009, we issued an external peer review report for the audit function of the National Science Foundation (NSF) OIG for the three year period ended September 30, 2008. The NSF OIG reported to our office that it does not have any outstanding recommendations related to the peer review report.

INVESTIGATIVE ACTIVITY

In accordance with professional standards and guidelines established by the Department of Justice, the OIG conducts investigations of criminal, civil, and administrative wrongdoing involving agency programs, operations and personnel. Our investigative program focuses on activities designed to promote accountability, effectiveness, and efficiency, as well as fighting fraud, waste, and abuse in agency programs and operations. In addition to our efforts to deter misconduct and promote integrity awareness among agency employees, we investigate referrals and direct reports of employee misconduct. Investigations may involve possible violations of regulations regarding employee responsibilities and conduct, Federal criminal law, and other statutes and regulations pertaining to the activities of NCUA employees.

Moreover, we receive complaints from credit union members and officials that involve NCUA employee program responsibilities. We examine these complaints to determine whether there is any indication of NCUA employee wrongdoing or misconduct. If not, we refer the complaint to the appropriate regional office for response, or close the matter if contact with the regional office indicates that the complaint has already been appropriately handled.

OIG HOTLINE CONTACTS

The OIG maintains a toll free hotline to enable employees and citizens to call with information about suspected waste, fraud, abuse or mismanagement involving agency programs or operations. We also receive complaints through an off-site post office box, from electronic mail, and facsimile messages. All information received from any of these sources is referred to as a *hotline contact*. The OIG hotline program is handled by our Office Manager, under the direction of our Director of Investigations. The majority of hotline contacts are from consumers seeking help with a problem with a credit union. These contacts are referred to the appropriate NCUA regional offices for assistance. During this reporting period, we referred 162 consumer complaints to regional offices. We referred two allegations of potential fraud at credit unions to the NCUA Office of General Counsel.

INVESTIGATIONS

Loan Fraud

During a previous reporting period, the OIG received an allegation that a NCUA senior employee may have been party to a loan fraud at a credit union. The OIG's investigation into the allegation led to a review of the employee's official filings of (1) Office of Government Ethics (OGE) 450's, Confidential Financial Disclosure Reports; and (2) SF85P, Questionnaire for Public Trust Positions. The investigation revealed that the employee omitted pertinent financial information on his OGE 450's. However, the investigation did not conclusively prove that the omissions were knowingly and willfully made, as required by 18 U.S.C. §1001 (false statements). Further, he gained no advantage from the omissions. In addition, the investigation did not reveal that the employee willfully made a materially false statement on his SF 85P. The employee admitted that in both cases, he failed to give the proper consideration to his obligation to file the forms to the best of his ability. The investigation concluded that his actions constituted administrative violations of the *Standards of Ethical Conduct for Employees of the Executive Branch* and OGE executive branch financial disclosure regulations.

The employee retired shortly after the report was issued with no action recommended from management.

Fair Labor Standards Act

During this reporting period, the OIG received an allegation that a contract employee was directed to “work off the clock.” The OIG inquired into the matter, and found no basis to support the complainant’s allegation. The OIG closed the inquiry with an Investigative Memorandum to the file.

Misuse of Official Time/Conflict of Interest

During the previous reporting period, the OIG received an allegation that an employee was misusing official time and using his position for personal gain. The OIG conducted a preliminary inquiry into the matter and did not develop substantive information to warrant further investigation. The inquiry was closed with an Investigative Memorandum to the file.

Standards of Ethical Conduct for Employees of the Executive Branch

During the current reporting period, the OIG received an allegation that an employee was using his position as a Credit Union examiner for private gain. This investigation is ongoing.

Fraud and Related Activity in Connection with Computers

During the current reporting period, the OIG received an allegation that an employee had accessed the email of another employee without authorization. This inquiry is ongoing.

PEER REVIEWS

April 1, 2010, through September 30, 2010.

Section 6(e)(7) of the Inspector General Act of 1978, as amended, requires those OIGs that have been granted statutory law enforcement authorities 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 investigation 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 intends to participate in the peer review process in the future and is tentatively scheduled to undergo an internal peer review in July 2011.

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 30 items, including proposed and final legislation and regulations, and Letters to Credit Unions. We issued formal comments on one legislative item.

SUMMARY OF STATUTES AND REGULATIONS REVIEWED	
Legislation	Title
P.L. 111-204	“Improper Payments Elimination and Recovery Act”
P.L. 111-203	“Dodd-Frank Wall Street Reform and Consumer Protection Act”
S. 372	“Whistleblower Protection Enhancement Act”
H.R. 4983	“The Transparency in Government Act”
H.R. 4735	“Ineligibility of Persons Having Seriously Delinquent Tax Debts for Federal Employment”
Regulations/Rulings	Title
12 CFR Part 701	Final rule: Short-Term, Small Amount Loans
12 CFR Part 701	Final rule: Secondary Capital Accounts
12 CFR Parts 740 and 745	Final rule: Display of Official Sign; Permanent Increase in Standard Maximum Share Insurance
12 CFR Part 701	Interim final rule and request for comments: The Low-Income Definition
12 CFR Part 707	Interim final rule and request for comments: Truth in Savings
12 CFR Part 701	Final rule: Chartering and Field of Membership for Federal Credit Unions
12 CFR Parts 741 and 761	Final rule: Registration of Mortgage Loan Originators; Correction
12 CFR Parts 741 and 761	Final rule: Registration of Mortgage Loan Originators

12 CFR Part 704	Proposed Interpretative Ruling and Policy Statement: Corporate Credit Unions
12 CFR Parts 741 and 750	Proposed rule: Golden Parachute and Indemnification Payments; Comments
Letters to Credit Unions	Title
10-CU-021(09/2010)	State of the Credit Union Industry
10-CU-020(09/2010)	NCUA's 2010 Corporate Credit Union Rule
10-CU-19 (09/2010)	Corporate Credit Union Resolution
10-CU-18 (09/2010)	Investment Due Diligence
10-CU-17 (09/2010)	NCUSIF Premium
10-CU-16 (08/2010)	Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risks
10-CU-15 (08/2010)	Indirect Lending and Appropriate Due Diligence
10-CU-14 (08/2010)	Strengthening Funding and Liquidity Risk Management
10-CU-13 (08/2010)	Compliance Deadline for SAFE Act
10-CU-12 (07/2010)	State of the Credit Union Industry as of March 31, 2010
10-CU-11 (06/2010)	Information on NCUA's Merger and Purchase and Assumption Process
10-CU-09 (06/2010)	Temporary Corporate Credit Union Stabilization Fund Assessment
10-CU-07 (06/2010)	Commercial Real Estate Loan Workouts
10-CU-06 (05/2010)	Interagency Advisory on Interest Rate Management
10-CU-04 (04/2010)	Grants Available from NCUA

TABLE I: INSPECTOR GENERAL ISSUED REPORTS WITH QUESTIONED COSTS				
		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.

TABLE II: INSPECTOR GENERAL ISSUED REPORTS WITH RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE			
		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
April 1 through September 30, 2010**

PART I – AUDIT REPORTS ISSUED

Report Number	Title	Date Issued
OIG-10-02	Material Loss Review of Center Valley FCU	4/14/2010
OIG-10-03	Material Loss Review of Cal State Credit Union	4/14/2010
OIG-10-04	Material Loss Review of Eastern Financial Florida Credit Union	5/05/2010
OIG-10-05	NCUA Financial Statements Audit 2008 – Operating Fund	6/11/2010
OIG-10-06	NCUA Financial Statements Audit 2008 – Share Insurance Fund	6/11/2010
OIG-10-07	NCUA Financial Statements Audit 2008 – Central Liquidity Facility	6/11/2010
OIG-10-08	NCUA Financial Statements Audit 2008 – Community Development Revolving Loan Fund	6/11/2010
OIG-10-09	NCUA Financial Statements Audit 2009 – Operating Fund	6/11/2010
OIG-10-10	NCUA Financial Statements Audit 2009 – Share Insurance Fund	6/11/2010
OIG-10-11	NCUA Financial Statements Audit 2009 – Central Liquidity Facility	6/11/2010
OIG-10-12	NCUA Financial Statements Audit 2009 – Community Development Revolving Loan Fund	6/11/2010
OIG-10-13	NCUA Financial Statements Audit 2009 – Temporary Corporate Credit Union Stabilization Fund	7/22/2010
OIG-10-14	Material Loss Review of Clearstar Financial Credit Union	9/22/2010
OIG-10-15	Material Loss Review of Ensign Federal Credit Union	9/23/2010

PART II – AUDITS IN PROGRESS *(as of September 30, 2010)*

Independent Evaluation of the NCUA’s Compliance with FISMA 2010
Material Loss Review of U.S. Central Corporate Federal Credit Union
Material Loss Review of Western Corporate Federal Credit Union
Material Loss Review of St. Paul Croatian Federal Credit Union
NCUA Financial Statements Audit 2010

INDEX OF REPORTING REQUIREMENTS		
Section	Data Required	Page Ref
4(a)(2)	Review of legislation and regulations	30
5(a)(1)	Significant problems, abuses, or deficiencies relating to the administration of programs and operations disclosed during the reporting period.	13
5(a)(3)	Recommendations with respect to significant problems, abuses or deficiencies	13
5(a)(3)	Significant recommendations described in previous semiannual reports on which corrective action has not been completed.	22
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.	34
5(a)(7)	Summary of particularly significant reports.	13
5(a)(8)	Statistical tables on audit reports with questioned costs.	32
5(a)(9)	Statistical tables on audit reports with recommendations that funds be put to better use.	33
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.	26
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.	26

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.

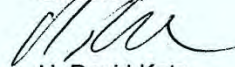
There are inherent limitations in the effectiveness of any system of quality control, and therefore noncompliance with the system of quality control may occur and not be detected. Projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality 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

Report No.	Report Date	Report Title
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

Report No.	Report Date	Report Title
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

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

NCUA System Review Report
Report No. 478

May 7, 2010