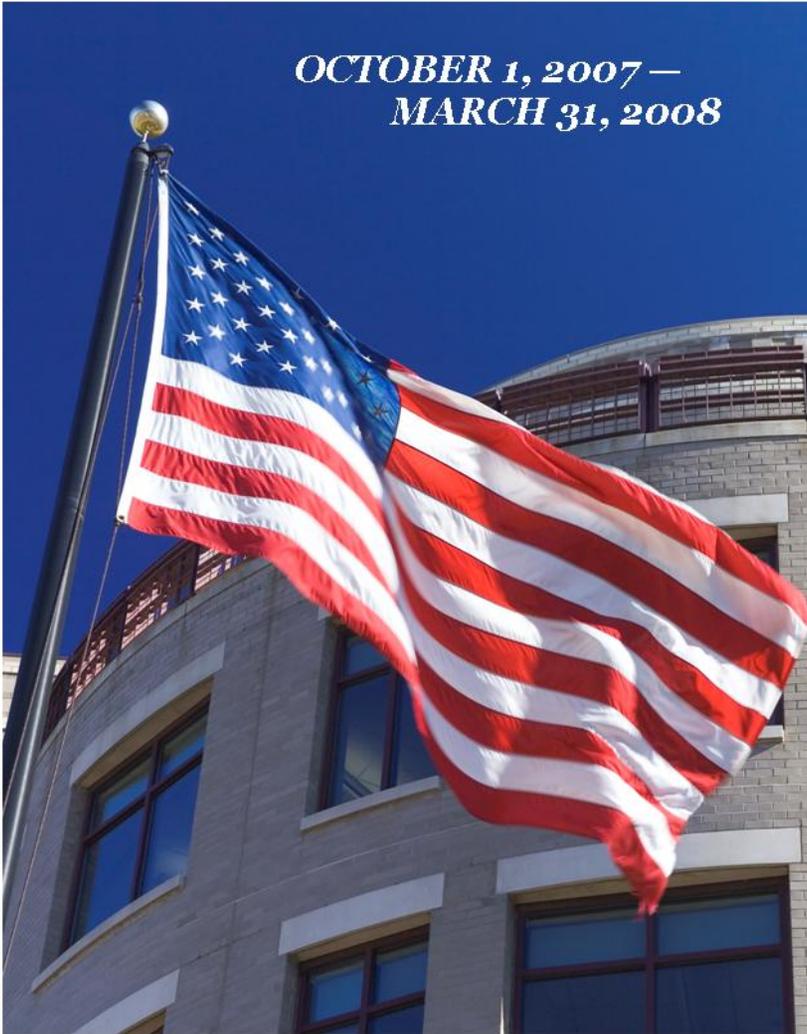


# SEMIANNUAL REPORT TO THE CONGRESS

OCTOBER 1, 2007 —  
MARCH 31, 2008



OFFICE OF THE INSPECTOR GENERAL  
NATIONAL CREDIT UNION ADMINISTRATION

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

I am pleased to present this Semiannual Report to Congress on the activities and accomplishments of the National Credit Union Administration (NCUA) Office of the Inspector General (OIG) for the period from October 1, 2007, to March 31, 2008. Our work reflects the legislative mandate of the Inspector General Act to promote the economy, efficiency, and effectiveness of NCUA programs and operations, and protect against fraud, waste, and abuse. The audits and investigations highlighted in this report demonstrate our commitment to ensuring integrity and efficiency in the NCUA's programs and operations, and enhancing public confidence in its regulatory process.

In addition to fulfilling our statutory mandate under the Inspector General Act, we are also responsible for evaluating the NCUA's information security program and practices under the Federal Information Security Management Act of 2002 (FISMA); reviewing and reporting on privacy and data protection matters under Office of Management and Budget (OMB) memoranda and guidance; supervising the preparation of the agency-wide, annual financial statement audit under the Federal Financial Management Improvement Act (FMFIA) of 1996; and performing material loss reviews of failed credit unions under the provisions of the Federal Credit Union Act.

My office is dedicated to maintaining the highest possible standards of professionalism and quality in its audits and investigations. I want to recognize the exemplary work of the auditors, investigators, and support staff who form the core of the NCUA OIG and are committed to promoting integrity and efficiency within the NCUA and its programs. With the recent retirement of one senior auditor on my staff, as well as the imminent retirement of our Director of Investigations, I look forward to their successors becoming a part of our quality-focused team which ensures excellence and trust in service to the NCUA and the public interest.

Finally, the success of the NCUA OIG would not be possible without the collaborative work between my staff and agency managers to address OIG findings and implement the recommendations made by my office. The Inspector General Act makes the OIG responsible for keeping both the NCUA Board and the Congress fully and currently informed about problems and deficiencies relating to NCUA programs and operations. This dual reporting responsibility makes our role unique at the NCUA and can present a number of challenges for establishing and maintaining an effective working relationship with management. Although we are an integral part of the NCUA, unlike any other NCUA region or office, our legislative underpinning requires us to operate as an independent and objective oversight unit at the same time. We wish to thank agency management for working with us in an objective and professional manner to ensure that we fulfill our obligation to recognize and address the risks, priorities, and needs of the NCUA.

William A. DeSarno  
Inspector General

## **THE NCUA MISSION**

NCUA's charge is to foster the safety and soundness of federally insured credit unions and to better enable the credit union community to extend the availability of financial services for provident and productive purposes to all who seek such service, while recognizing and encouraging credit unions' historical emphasis on extension of financial services to those of modest means.

The NCUA's mission is accomplished by managing the National Credit Union Share Insurance Fund in an efficient and prudent manner through an effective supervision program and a regulatory environment that encourages innovation, flexibility and continued focus on attracting new members and improving financial service to existing members.



## **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**

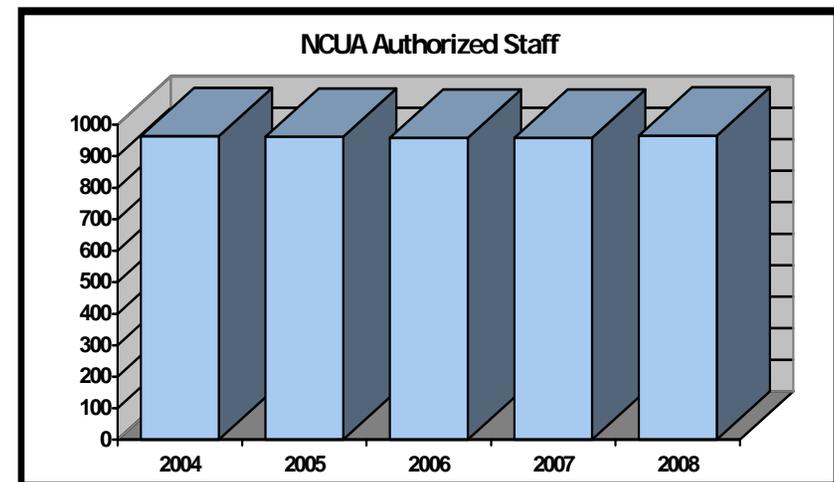
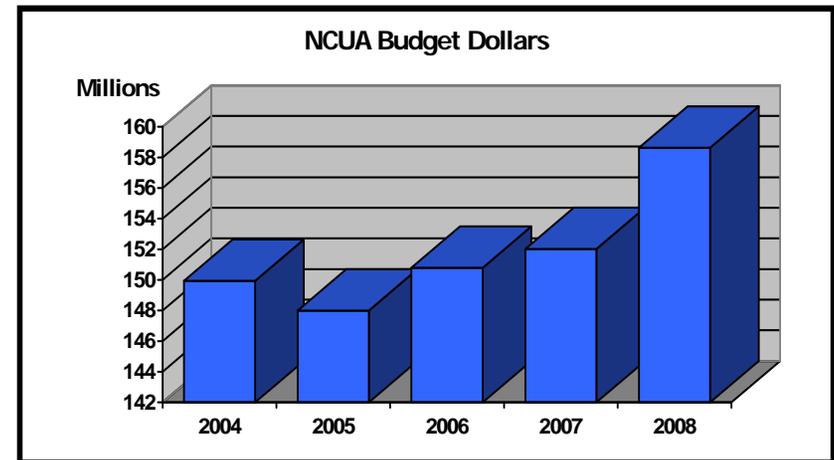
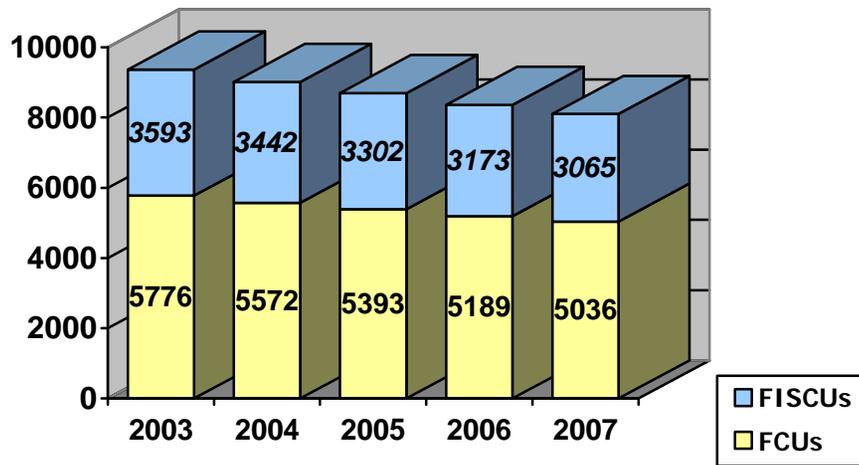
The National Credit Union Administration (NCUA) was established as an independent, federal regulatory agency on March 10, 1970. The agency is responsible for chartering, examining, supervising, and insuring federal credit unions. It also insures state-chartered credit unions that have applied for insurance 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, 2007, the NCUA was supervising and insuring 5,036 federal credit unions and insuring 3,065 state-chartered credit unions, a total of 8,101 institutions. This represents a decline of 82 federal and 55 state-chartered institutions since June 30, 2007, for a total decline of 137 credit unions nationwide, primarily as a result of mergers.

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 National Credit Union Administration, including the NCUA Operating Fund, the Share Insurance Fund, the Central Liquidity Facility, and the Community Development Revolving Loan 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 on page 5.

The NCUA Board adopted its 2008 budget of \$158,631,447 on November 15, 2007. The Full-Time Equivalent (FTE) staffing authorization for 2008 is 965, representing an increase of seven FTEs from 2007.

**Federally Insured Credit Unions**



**NATIONAL CREDIT UNION ADMINISTRATION  
ORGANIZATIONAL CHART**



**NCUA HIGHLIGHTS**

**NCUA ISSUES STATEMENT IN RESPONSE TO  
TREASURY DEPARTMENT REPORT ON FINANCIAL  
REGULATORY STRUCTURE**

On March 31, 2008, Secretary Henry J. Paulson, Jr., of the United States Treasury Department, announced the release of the Department's report entitled *Blueprint for a Modernized Financial Regulatory Structure*. In its media response to the report, the NCUA stated that the Executive Summary of the Treasury Report raised important issues about the optimal structure for governmental oversight of U.S. financial markets. While it agreed with the premise of the report that the ultimate objective of that oversight is "a sound and competitive financial services industry grounded in robust consumer protection and stable and innovative markets," the NCUA stated its concerns that many consumer benefits of the credit union system would be threatened by any restructuring proposal that may blur the credit union charter and that eliminates the separate regulatory and insurance function for federally insured credit unions.

The Agency stated its intent to conduct a detailed review of the report and indicated that it looks forward to a full and public dialogue on the issues raised. NCUA noted that its starting point for review will be the proposals reflected in NCUA Chairman JoAnn Johnson's letter of November 20, 2007, to Secretary Paulson, which recommended a continued separate charter and separate regulatory and insurance regime for credit unions, and recommended

further strengthening of the credit union system through capital reform and other measures.

### **CHAIRMAN JOHNSON TESTIFIES ON MODERNIZATION**

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On March 6, 2008, NCUA Chairman Johnson testified before the U.S. House Financial Services Committee hearing on "The Need for Credit Union Regulatory Relief." The hearing provided a comprehensive examination of needed regulatory relief for credit unions, including a review of current legislative proposals and industry issues. In her testimony, Chairman Johnson highlighted two paramount issues: prompt corrective action (PCA) reform and extending credit union service to consumers in underserved areas. Chairman Johnson also noted the importance of strong, active NCUA supervision, stressing the Agency's significant attention to guidance to credit unions in all types of lending, including member business lending.

### **HYLAND TRANSMITS OUTREACH TASK FORCE REPORT TO NCUA BOARD**

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On February 26, 2008, NCUA Board Member Gigi Hyland formally presented the Outreach Task Force Report to the NCUA Board. The Outreach Task Force was created by NCUA Chairman Johnson subsequent to receiving the 2006 Member Service Assessment Pilot (MSAP) Report, which was the NCUA response to questions raised by Congress and the Government Accountability Office regarding

federal credit union fulfillment of their mission and purpose. The MSAP Report concluded that federal credit unions are succeeding in serving those they are chartered to serve, but given greater scope and opportunity, federal credit unions can improve the availability of financial services to low and moderate income consumers and those living in underserved areas. "The report identifies serious, specific recommendations to help federal credit unions serve consumers across all parts of their fields of membership, consistent with the purpose set forth in the preamble to the Federal Credit Union Act," said Board Member Hyland, who was appointed Chair of the Outreach Task Force in 2006.

The Outreach Task Force's mission was threefold:

1. Evaluate and determine the appropriateness of three recommendations from the agency's 2006 *Member Service Assessment Pilot Program: A Study of Federal Credit Union Service*;
2. Assess the agency's current role and efforts with respect to credit union service to their members; and
3. Assess the recommendations made by the Government Accountability Office in its 2006 report (GAO-07-29).

The process involved an extensive review of NCUA policies and procedures in four areas: collection of membership profile and financial services data; senior executive compensation; low-income definition; and outreach. In addition, the Outreach Task Force heard a variety of viewpoints through its six public Town Hall meetings held in Cincinnati, OH, Boston, MA, New Orleans, LA, Los Angeles, CA, Denver, CO, and Washington, DC from April through October 2007. Board Member Hyland

also held dozens of other meetings to discuss the Task Force's efforts during her numerous visits around the country.

### **NCUA COMPLETES NEGOTIATIONS WITH NTEU**

NCUA completed negotiations with the National Treasury Employees Union (NTEU) Chapter 303 on the first collective bargaining agreement for NCUA employees on Thursday, November 1, 2007. The 3-year contract provides the framework of working conditions for the NCUA bargaining unit, which includes field examiners and office employees. As an independent, federal agency, NCUA is one of the few agencies with the authority to bargain over compensation as well as working conditions. The contract addresses travel, work locations and work schedules, compensation and benefits, and other areas of concern raised by both management and bargaining unit representatives.

Under the terms of the agreement, NCUA bargaining unit employees will retain flexible work schedules, local duty stations, and relocation benefits. While the negotiated contract maintains a mobile workforce, it preserves management's right to assign and approve work in order to manage work flow and team schedules.

### **VICE CHAIRMAN HOOD NAMED YOUNG GLOBAL LEADER**

The World Economic Forum named NCUA Vice Chairman Rodney E. Hood a Young Global Leader 2008. The World Economic Forum bestows the annual award to recognize and

acknowledge the top 200–300 young leaders (age 40 or under) from around the world for their professional accomplishments, commitment to society, and potential to contribute to shaping the future of the world. The 2008 awardees include 121 business leaders as well as leaders from government, academia, media, and society from 65 countries. Selected from a pool of 5,000 candidates, the Young Global Leaders 2008 were chosen by a selection committee of 31 eminent international media leaders. Established in 2004, the Forum of Young Global Leaders give their time to task forces to initiate, develop, and drive innovative solutions on important, globally-oriented issues, including health, the environment, global governance and security, and development and poverty.

### **BOARD MEMBER HYLAND URGES PROACTIVE, BALANCED APPROACH ON MORTGAGES**

On December 6, 2007, NCUA Board Member Hyland testified before a House Financial Services Committee hearing on "Accelerating Loan Modifications, Improving Foreclosure Prevention and Enhancing Enforcement." At that hearing, Hyland assessed a series of federal and state proposals to improve the pace and volume of mortgage loan modifications, which may help troubled borrowers remain in their homes. She told Congress that NCUA favors a balanced approach to restructuring of home mortgages that allows for "prudent workout arrangements" that "benefit both credit unions and their members."

During her testimony, Board Member Hyland addressed H.R. 4178, legislation introduced by Representative Michael Castle (R-DE), which would provide for a safe harbor from legal

liability for mortgage market participants who modify mortgage loans according to certain criteria, an FDIC proposal in response to that bill, a California proposal between the state and large mortgage servicers, and a draft amendment to increase penalties on lenders who engage in a pattern of unfair or abusive lending practices. Hyland articulated the Agency's support of good faith attempts to facilitate loan modifications.

Citing NCUA and interagency guidance on subprime lending that had been issued in the months prior to the hearing, Hyland underscored the importance of enhanced NCUA oversight of this type of lending activity by credit unions. Her testimony also noted that, while delinquencies and foreclosures in credit union mortgage lending have increased, they remain a very small part of overall credit union real estate lending.

Hyland also offered suggestions regarding the several proposals before the Committee, including broadening language to include FHA as well as VA loans in a definition of mortgages qualified for certain workout plans, extending the window for workouts and modifications from 6 to 12 months, and conforming a definition of "reasonably foreseeable default" to one used by NCUA and other regulators in lending guidance issued earlier this year.

## **CHAIRMAN JOHNSON TESTIFIES ON MORTGAGE REFORM**

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NCUA Chairman JoAnn Johnson testified on October 24, 2007, on mortgage reform before the House Financial Services Committee. The Legislative Proposals on Reforming

Mortgage Practices hearing included three panels—federal regulators and state banking supervisors, consumer groups, and industry trade associations.

Commenting on mortgage reform legislation introduced by senior House Financial Services Committee Democrats, Chairman Johnson outlined credit unions' role in the mortgage lending market and NCUA's mortgage lending guidance. She also offered NCUA views on the proposed legislation. Chairman Johnson called on the Committee to include NCUA in the rulemaking process set forth by this legislation.

## **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, 2007, quarterly call reports submitted by all federally insured credit unions found that key financial indicators were mixed.

### **KEY FINANCIAL INDICATORS SHOWING CONCERN**

Looking at the December 31, 2007 quarterly statistics for major balance sheet items and key ratios shows the following for the nation's 8,101 federally insured credit unions: assets grew 6.12 percent; net worth to assets ratio decreased from 11.53 to 11.44 percent; the loan to share ratio increased from 82.23 percent to 83.32 percent; the delinquency ratio increased from .68 to .93 percent; and credit union return on average assets decreased from .82 percent to .65 percent.

### **SAVINGS SHIFTING TO CERTIFICATES OF DEPOSIT**

Total insured share accounts increased 5.19 percent. Share certificates increased 14.42%. Regular shares comprise 26.63 percent of total share accounts; share certificates comprise 34.17 percent; money market shares comprise 17.58 percent; and share draft accounts comprise 11.33 percent; and all other share accounts comprise 10.29 percent.

## **LOANS INCREASED**

Loan growth of 6.58 percent resulted in an increase in total loans by \$32.54 billion. Total net loans of \$527 billion comprise 70 percent of credit union assets. Real estate loans increased 20.94 percent. First mortgage real estate loans are the largest single asset category with \$179.44 billion accounting for 34.05 percent of all loans. Other real estate loans of \$91.67 billion account for 17.4% of all loans. Used car loans of \$89.1 billion were 16.91% of all loans, while new car loans amounted to \$86.9 billion or 16.49% of total loans. Credit card loans totaled \$30.12 billion or 5.72% of total loans and other loans totaled \$49.69 billion for 9.4% of total loans.

## LEGISLATIVE HIGHLIGHTS

### **HOUSE INTRODUCES H.R. 5519, "THE CREDIT UNION REGULATORY RELIEF ACT OF 2008"**

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On March 3, 2008, Reps. Barney Frank (D-Mass.), Paul Kanjorski (D-Pa.), and Ed Royce (R-Calif.) introduced a new credit union bill (H.R. 5519), which would offer regulatory relief in 12 areas, but does not go as far as the Credit Union Regulatory Improvements Act (CURIA, H.R. 1537). The bill was introduced four days before a scheduled House Financial Services Committee hearing on CURIA. Rep. Frank is the chairman of that committee and Rep. Kanjorski heads that panel's subcommittee on capital markets. Although it touches on many areas of CURIA, the new bill does not contain language to increase the credit union member business lending ceiling or to transform prompt corrective action into a more risk-based system. H.R. 5519 is entitled the Credit Union Regulatory Relief Act (CURRA) of 2008."

### **BUSH PROPOSES \$1,000,000 FOR CDRLF PROGRAMS**

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On February 4, 2008, President Bush released his proposed federal budget for fiscal year 2009. He proposed \$1,000,000 for the Community Development Revolving Loan Fund (CDRLF) program. NCUA administers the CDRLF, which is used to provide low-interest loans and technical assistance grants to low income designated credit unions. These small credit unions offer services like income tax preparation and financial literacy classes. Within NCUA, the Office of Small Credit Union Initiatives administers the fund.

NCUA made a total of 46 loans for \$8 million from the fund through the first 11 months of 2007. This was the largest number of loans ever approved in a single year by the fund. As of November 30, 2007, the CDRLF's total loan portfolio reached \$13.4 million, its highest total ever. In addition, as of September 30, 2007, the CDRLF funded 307 technical assistance grants to low-income credit unions.

### **NCUA JOINS OTHER AGENCIES IN RELEASING PROPOSED REVISIONS TO QUESTIONS AND ANSWERS REGARDING FLOOD INSURANCE**

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To help financial institutions meet their responsibilities under Federal flood insurance legislation and to increase public understanding of their flood insurance regulations, the NCUA joined federal bank, thrift and Farm Credit System regulatory agencies in requesting public comment on new and revised interagency questions and answers regarding flood insurance. The Federal Register notice and request for comment was issued on March 21, 2008. The *Interagency Questions and Answers Regarding Flood Insurance* were first published in 1997 under the auspices of the Federal Financial Institutions Examination Council. NCUA and the other agencies are proposing new questions and answers, as well as substantive modifications to questions and answers pertaining to construction loans and condominiums. The agencies are also proposing new questions and answers in a number of areas, including second lien mortgages, the imposition of civil money penalties, and loan syndications/ participations. Finally the agencies are proposing to revise and reorganize certain existing questions and answers to clarify areas of potential misunderstanding and to provide clearer guidance to users.

The agencies invited comment on the proposed changes and, more generally, on other issues regarding compliance with the Federal flood insurance statutes and regulations.

### **NCUA, FINANCIAL REGULATORY AGENCIES ISSUE FINAL RULES ON AFFILIATE MARKETING**

On January 1, 2008, final rules issued by the NCUA and the other Federal financial regulatory agencies (Federal Reserve Board, Federal Deposit Insurance Corporation, and the Department of the Treasury's Office of the Comptroller of the Currency and Office of Thrift Supervision) went into effect that provide consumers with an opportunity to "opt out" before a financial institution uses information provided by an affiliated company to market its products and services to the consumer. The final rules on affiliate marketing implement section 214 of the Fair and Accurate Credit Transactions Act of 2003, which amends the Fair Credit Reporting Act (FCRA).

The final rules generally prohibit a financial institution from using certain information received by an affiliate to make a solicitation to a consumer unless the consumer is given notice and a reasonable opportunity to opt out of such solicitations, and the consumer does not opt out. Nothing in the final rules supersedes or amends a consumer's existing right to opt out of the sharing of non-transaction or experience information under section 603(d) of the FCRA. The final rules also implement the statutory exceptions to the affiliate marketing notice and opt out requirement. All covered entities must comply with the rules no later than October 1, 2008. Substantially similar rules will be issued by the Federal Trade Commission and the Securities and Exchange Commission.

## **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 in 1988. The staff consists of the Inspector General, Counsel to the Inspector General, Assistant Inspector General for Audits, Director of Investigations, 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

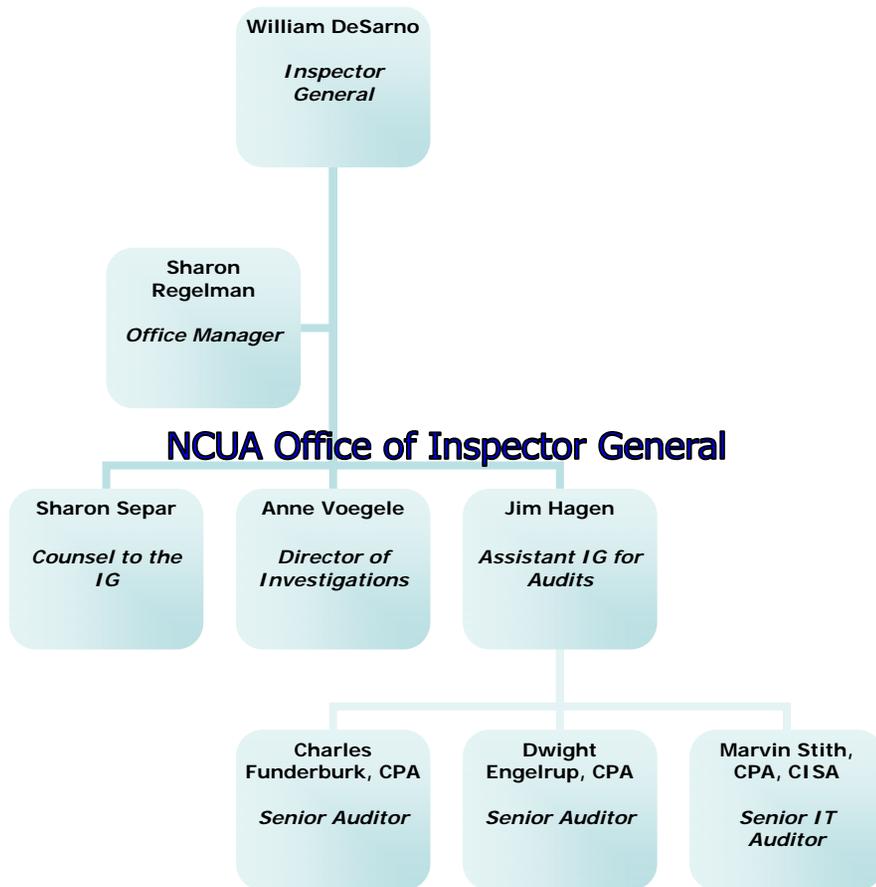
*OIG-07-10 – October 2, 2007*

#### OFFICIAL PERSONNEL FOLDERS

Official Personnel Folders (OPFs) contain records that document an individual employee's Federal government employment history. The OPF follows an employee throughout his or her Federal career. Due to the importance of OPFs, the current Federal emphasis on protecting Personally Identifiable Information (PII), and the attention to this issue by the Office of Management and Budget (OMB), as part of the President's Management Agenda, the Office of Inspector General (OIG) added this survey review to its 2007 Annual Performance Plan. Our objectives were to determine whether NCUA is accurately maintaining and storing OPFs, and to evaluate the agency's ability to migrate to an electronic OPF system. Our primary office of review was the NCUA Office of Human Resources (OHR).

*We Reviewed OPM Requirements and Guidance as well as NCUA OHR Internal Controls*

We concluded that the NCUA OHR is aware of OPM's regulatory requirements and guidance for compiling and maintaining OPFs. However, OHR reported that, with the exception of its Physical Security Plan (security plan) which addresses disaster recovery planning, it has no written internal control procedures, such as document checklists or management monitoring reports, to ensure that OHR staff members are fully complying with OPM requirements. We



determined that OHR can, by developing its own internal control procedures, ensure that it is better adhering to OPM requirements and guidance and, consequently, ensure the accuracy and completeness of the OPFs it maintains.

*We Reviewed NCUA's Maintenance of OPFs and Performed a Sample Review of 30 OPFs*

We concluded that OHR could improve its maintenance of OPFs. Specifically, we observed that OHR needs to develop formal internal control procedures to ensure that OHR staff is maintaining OPF documentation in a complete and accurate manner. This is especially important as OHR considers transitioning in the future to an electronic OPF system. During our sample review, we observed that the documentation maintained in OPFs for the past five years was generally complete. However, in this same sample, we found that for the complete time frame of the OPF, over 50% of the OPFs were either incomplete or contained errors. Consequently, our report contains three recommendations for operational improvement. Management has already or is in the process of taking corrective action to address our recommendations.

*We Reviewed NCUA Plans and Ability to Transition to Electronic OPF; eOPF; and Image Now*

We concluded that NCUA does not now have electronic Official Personnel Folders (OPF) or the current ability to transition to an electronic OPF sanctioned by the Office of Personnel Management (OPM). We observed the OHR is interested in converting to electronic OPFs, and has taken steps to obtain information preparatory to selection of the eOPF system approved by and supported by OPM.

We also determined that NCUA does not have a completed electronic image of OPFs for the purpose of disaster recovery. Our report contains one recommendation for operational improvement in this area.

NCUA management agreed with all recommendations and has or is in the process of taking corrective action to address the recommendations.

*OIG-07-11 – November 15, 2007*

**FOLLOW-UP REVIEW OF NCUA ENCRYPTION**

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) performed an audit to determine if NCUA is adequately protecting sensitive electronic data. To determine whether the NCUA adequately protects sensitive electronic data, we interviewed a judgmental sample of examiners and reviewed the examiners' computer equipment<sup>1</sup>. We also interviewed the Chief Information Officer and reviewed policies and procedures related to protecting sensitive data.

We determined that the NCUA is adequately protecting sensitive electronic data. The examiners were primarily saving exam-related files to their encrypted 'My Documents' folder as advised by the OCIO. In addition, we did not identify any unencrypted exam files on the NCUA-issued hard drives. However, we determined the NCUA could make improvements to better protect this data. Specifically, while 94 percent of the exam files we identified on the laptops we reviewed were encrypted, some examiners had potentially sensitive unencrypted credit union data on their computer equipment. In addition, there was unrestricted access to sensitive credit

<sup>1</sup> Computer equipment includes NCUA-issued laptops, external hard drives, and USB flash drives, and unencrypted media such as USB flash drives and CDs.

union data on the NCUA intranet. We also learned that while the encryption technology the NCUA used adequately protected sensitive data if used as guided, the NCUA OCIO was planning to implement a strategy to better protect electronic PII and other sensitive data.

Our report included five recommendations to NCUA to improve the security, access and storage of sensitive credit union data. NCUA management agreed with all five recommendations and is in the process or already has taken corrective action to address the recommendations.

*OIG-08-01, 02, 03, & 04 – February 28, 2008*

#### **NCUA FINANCIAL STATEMENTS**

Our contracting audit firm, Deloitte & Touche LLP, issued opinions on the 2007 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, 2007. The firm issued its opinions on February 13, 2008.

**THE NCUA OPERATING FUND (OIG-08-01)** 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 funds total assets for 2007 were \$60.8 million, down from \$63.5 million in 2006.

**THE NATIONAL CREDIT UNION SHARE INSURANCE FUND (OIG-08-02)** 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 2007 were \$7.5 billion, up from \$7.1 billion in 2006.

**THE CENTRAL LIQUIDITY FACILITY (OIG-08-03)** 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 2007 were \$1.7 billion, up from \$1.6 billion in 2006.

**THE COMMUNITY DEVELOPMENT REVOLVING LOAN FUND'S (OIG-08-04)** 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 2007 were \$16.3 million, up from \$16.1 million in 2006.

The financial auditors did not find any matters considered to be *material* weaknesses in their review of the Funds' internal control structures pertinent to financial reporting. However, during the performance of the audit, several observations and recommendations were presented relating to internal control over financial reporting, and certain other accounting, administrative, and operating matters.

*OIG-08-05 – March 21, 2008*

#### **LOW INCOME CREDIT UNION GRANT AND LOAN REVIEW**

The NCUA Office of Inspector General (OIG) performed a review to determine the following: (1) how loan and TAG funds under the CDRLF program are awarded; (2) whether the

loans and grants are awarded competitively; and (3) whether the loan and grant program contingencies are being met.

In addition to meeting basic eligibility standards, both CDRLF loan and grant applicants must meet additional regulatory and statutory criteria and provide specific information to qualify as award participants. OSCUI staff analyzes the applications to ensure that standards and criteria are met. In the cases we reviewed, all participating credit unions that received loan and grant awards met the requisite eligibility requirements. Subsequent to the award of a CDRLF loan or grant, participating credit unions must file annual progress reports; subsequent to the award of a CDRLF grant, participating credit unions must file an outcome summary report and an expense reimbursement request upon completion of the award project.

Although we found that both the CDRLF loan and TAG programs generally meet the objectives of the CDRLF, we made fourteen recommendations for areas where improvement could be made. The areas for improvement were concentrated in the award application and analysis process and in the post award monitoring of CDRLF loans and grants. Management generally agreed with most of the reports recommendations and has already taken action to address a number of the report's recommendations in its 2007 grant and loan process.

## AUDITS IN PROGRESS

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### REVIEW OF SMART CARDS

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The Office of Inspector General is initiating a review of NCUA's implementation of Smart Cards. This review is part of the Office of Inspector General's 2008 Performance Plan.

On August 27, 2004, the President signed Homeland Security Presidential Directive – 12 (HSPD-12) - Policy for a Common Identification Standard for Federal Employees and Contractors. HSPD -12 provides policy to enhance security, increase Government efficiency, reduce identity fraud, and protect personal privacy by establishing a mandatory, Government-wide standard for secure and reliable forms of identification issued by the Federal Government to its employees and contractors (including contractor employees). "Secure and reliable forms of identification" for purposes of this directive means identification that (a) is issued based on sound criteria for verifying an individual employee's identity; (b) is strongly resistant to identity fraud, tampering, counterfeiting, and terrorist exploitation; (c) can be rapidly authenticated electronically; and (d) is issued only by providers whose reliability has been established by an official accreditation process. On August 5, 2005, OMB issued a memorandum that provided instructions to agencies for implementing the Directive and FIPS 201. HSPD-12 requires agencies to conduct a background investigation, adjudicate the results, and issue identity credentials to their employees and contractors who require long-term access to federally controlled *facilities* or *information systems*. However, it does not apply to individuals under contract to a department or agency, requiring only intermittent access to federally

controlled *facilities*. Our objective is to assess the status of the NCUA's implementation of the Smart Card program.

#### **REVIEW OF FINANCIAL ACCOUNTING SOFTWARE CONVERSION**

NCUA's current financial accounting software is expected to be unsupported by the vendor within the next one to two years. Therefore the agency is in the process of selecting new financial accounting software. The OCFO believes the agency needs a system which will support the federal standard general ledger (SGL) and a system which should be hosted off-site. The total estimated cost is over \$5 million. The OCFO proposed \$2.7 million in the 2008 NCUA capital budget with the remainder incorporated into the 2009 capital budget. The objective of our review is: Does NCUA have an adequate methodology for the acquisition of financial accounting software?

#### **MATERIAL LOSS REVIEWS OF HURON RIVER AND NORLARCO**

The FCU Act provides that a review is required when the share insurance fund (Fund) incurs a material loss. For purposes of determining whether the Fund has incurred a material loss with respect to an insured credit union such that the Inspector General (OIG) of the NCUA Board (Board) must make a report, a loss is material if it exceeds the sum of \$10,000,000, and an amount equal to 10 percent of the total assets of the credit union at the time at which the Board initiated assistance under section 208 or was appointed liquidating agent.

On February 1, 2008, the OIG was notified by NCUA that two credit unions (Huron River and Norlarco) losses had exceeded the requirements triggering a material loss review by the OIG. The scope of this audit will include an analysis of the credit union's transactions and activities to determine the causes of failure and a review of the state and/or NCUA supervision of the credit union. The audit 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.

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

As of March 31, 2008, 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.

## **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 and personnel. Our investigative program focuses on activities designed to promote economy, effectiveness, and efficiency, as well as fighting fraud, waste, and abuse in agency programs. 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 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**

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The OIG maintains a toll free hotline to enable employees and citizens to call with information about 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 office for assistance. During this reporting period, we referred 193 consumer complaints to regional offices. Also during this reporting period, we referred one allegation back to agency management for action.

### **INVESTIGATIONS**

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#### **FALSE STATEMENTS**

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During this reporting period, the OIG received an allegation that an NCUA employee may have made false statements and false representations on her time and attendance documentation. The original allegation and supporting documentation indicated that the abuse was substantive. The OIG investigated and found the more serious allegations to be untrue based on faulty monitoring equipment which resulted in inaccurate documentation. The remaining issues were referred back to the employee's office for management action.

#### **ABUSE OF AUTHORITY**

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The OIG received an allegation that an NCUA examiner had abused his authority and had engaged in an inappropriate relationship with a credit union employee. That investigation is ongoing.

**SEXUAL HARASSMENT**

During the last reporting period, the OIG reported on an ongoing investigation that an NCUA Examiner sexually harassed several women. The results of that investigation determined that the women in question had participated in an electronic mail exchange with the employee which contained sexually suggestive language. Additionally, the investigation revealed that the employee’s supervisors had gone to great lengths to obtain the complaint from one of the women. Based on our review of the relevant materials and the circumstances that surround the development and reporting of the original complaint, the OIG determined that there was insufficient evidence to either substantiate or disprove an allegation of sexual harassment.

**OFFICE OF SPECIAL COUNSEL REQUEST**

The OSC referred to the OIG a whistleblower allegation concerning the agency’s policies and practices related to documenting and compensating employee hours of work. The OIG conducted an initial investigation on the matter and provided a report to the Office of Special Counsel.

**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 18 items, including proposed and final legislation and regulations, comments to proposed regulations, and agency Interpretive Rulings and Policy Statements.

<b>SUMMARY OF STATUTES AND REGULATIONS REVIEWED</b>	
<b>Legislation/E.O.</b>	<b>Title</b>
H.R. 4791	“Federal Agency Data Protection Act”
H.R. 5519	“The Credit Union Regulatory Relief Act Of 2008”
<b>Regulations/Rulings</b>	<b>Title</b>
12 CFR Part 41; 12 CFR 717; 12 CFR Part 222; 12 CFR Parts 334 and 364; 12 CFR Part 571	Joint Final Rule and Guidelines: “ Identity Theft Red Flags and Address Discrepancies Under the Fair and Accurate Credit Transactions Act”
12 CFR Part 797	Final Rule: “Procedures for Debt Collection”
12 CFR Part 701.23	Final Rule: “Purchase, Sale and Pledge of Eligible Obligations”
12 CFR Part 717	Final Rule: “Identity Theft Red Flags And Address Discrepancies under The FACT Act”

12 CFR Part 717	Final Rule: "Fair Credit Reporting: Affiliate Marketing"
12 CFR Part 701	Final Rule: "Reincorporation of FCU By-laws Into NCUA Regulations"
12 CFR Part 711	Final Rule: "Management Official Interlocks Threshold Change"
12 CFR Parts 708a and 708b	Advance Notice of Proposed Rule-making and Request for Comment (ANPR): "Mergers, Conversion from Credit Union Charter, and Account Insurance Termination"
12 CFR Part 797	Final Rule: "Procedures for Debt Collection"
FIN 2008-R001	Financial Crimes Enforcement Network (FinCen) administrative ruling: "Reporting of Currency Transactions For Sole Proprietorships and Legal Entities Operating Under a "Doing Business As" Name"
IRPS 08-1	Proposed Interpretative Ruling and Policy Statement 08-1: "Guidance Regarding Prohibitions Imposed by Section 205(d) Of the Federal Credit Union Act"
12 CFR part 760	Proposed Interagency Questions and Answers Regarding Flood Insurance
12 CFR Part 740	Proposed Rulemaking: "The Official Advertising Statement"
12 CFR Parts 708a And 708b	"Mergers, Conversions from Credit Union Charter, and Account Insurance Termination-Comments"
12 CFR Part 717	Interagency Notice of Proposed Rulemaking: Procedures to Enhance the Accuracy and Integrity of Information Furnished to Consumer Reporting Agencies
	Joint Interagency Guidance on Garnishment Of Federal Benefit Payments-Comments

<b>TABLE I</b> <b>INSPECTOR GENERAL ISSUED REPORTS</b> <b>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 disallowed	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</b> <b>INSPECTOR GENERAL ISSUED REPORTS WITH</b> <b>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.

<b>TABLE III</b> <b>SUMMARY OF OIG ACTIVITY</b> <b>OCTOBER 1, 2007 THROUGH MARCH 31, 2008</b>		
PART I – AUDIT REPORTS ISSUED		
Report Number	Title	Date Issued
OIG-07-10	NCUA's Risk Focused Examinations Tracking Identified Documents of Resolution	07/10/2007
OIG-07-11	Real Estate Lending	09/05/2007
OIG-08-01	NCUA Financial Statement Audit: The NCUA Operating Fund	02/28/2008
OIG-08-02	NCUA Financial Statement Audit: The National Credit Union Share Insurance Fund	02/28/2008
OIG-08-03	NCUA Financial Statement Audit: The Central Liquidity Facility	02/28/2008
OIG-08-04	NCUA Financial Statement Audit: The Community Development Revolving Loan Fund	02/28/2008
OIG-08-05	Low Income Credit Union Grant and Loan Review	03/21/2008
PART II – AUDITS IN PROGRESS <i>(as of March 31, 2008)</i>		
	Review of Smart Cards	
	Review of Financial Accounting Software Conversion	
	Material Loss Reviews of Huron River and Norlarco	

**INDEX OF REPORTING REQUIREMENTS**

<b>SECTION</b>	<b>DATA REQUIRED</b>	<b>PAGE REF</b>
4(a)(2)	Review of Legislation and Regulations	32
5(a)(1)	Significant Problems, Abuses, or Deficiencies Relating to the administration of programs and Operations disclosed during the reporting period.	20
5(a)(3)	Recommendations with Respect to Significant Problems, Abuses, or Deficiencies.	20
5(a)(3)	Significant Recommendations Described in Previous Semiannual Reports on Which Corrective Action Has Not Been Completed.	28
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.	36
5(a)(7)	Summary of Particularly Significant Reports.	20
5(a)(8)	Statistical Tables on Audit Reports With Questioned Costs.	34
5(a)(9)	Statistical Tables on Audit Reports With Recommendations That Funds Be Put To Better Use.	35
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

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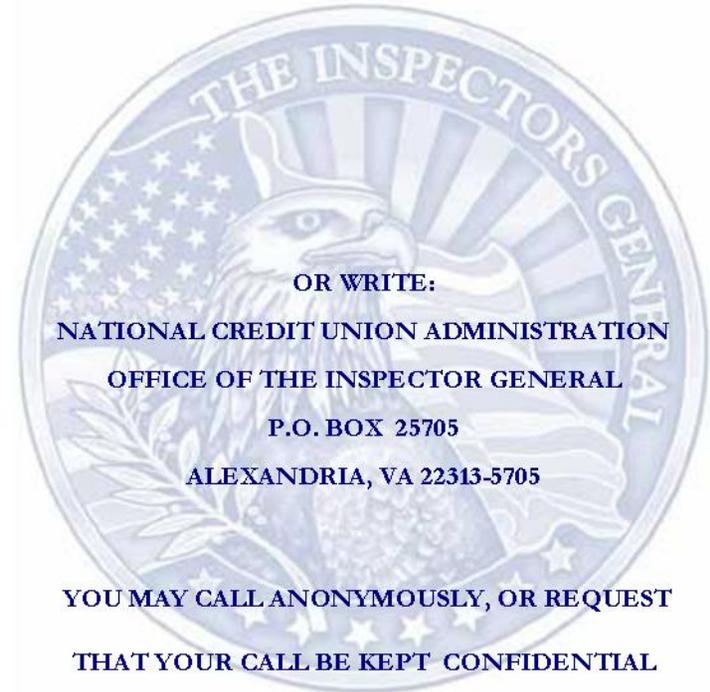
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