

NCUA

OFFICE OF INSPECTOR GENERAL

SEMIANNUAL REPORT TO THE CONGRESS

NATIONAL CREDIT UNION ADMINISTRATION



APRIL 1—SEPTEMBER 30, 2008

National Credit Union Administration

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

I am pleased to present the National Credit Union Administration (NCUA) Office of Inspector General (OIG) Semiannual Report summarizing activities for the 6-month period from April 1, 2008, through September 30, 2008.

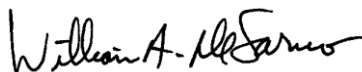
Over the past 6 months we ensured the completion of mandated work including the audit of the agency's 2007 consolidated financial statement required by the Government Management Reform Act and the independent evaluation of NCUA's information security program as required by the Federal Information Security Management Act (FISMA).

As we enter the next reporting period, the most significant factor impacting our office is the requirement for us to perform material loss reviews (MLR) of failed credit unions regulated and/or insured by NCUA that result in material losses to the National Credit Union Share Insurance Fund (NCUSIF). The Federal Credit Union Act, 12 U.S.C. 1790d(j), defines a material loss as (1) exceeding the sum of \$10 million; and (2) an amount equal to 10% of the total assets of the credit union at the time at which the NCUA Board initiated assistance or was appointed liquidating agent.

We are near completion of a MLR of Huron River Area Credit Union. Its estimated loss to the NCUSIF is \$38.7 million. Moreover, we are scheduled to conduct two additional MLRs, to be completed in 2009. Even a moderate increase in credit union failures would trigger an MLR workload for us that would be beyond our resource capability. We are coordinating with the other financial regulatory OIGs who have MLR responsibilities to identify strategies to address the potential for a significant increase in workload. Nevertheless, to staff the MLR currently in progress as well as the additional MLRs currently scheduled, we have deferred previously planned discretionary audits of important NCUA programs and operations. The NCUA Board has expressed its support of our MLR work and is cognizant of its impact on our ability to undertake additional audits.

The profound changes that we anticipate in the wake of the passage of the “Emergency Economic Stabilization Act of 2008,” may also give rise to areas of known or emerging risks and vulnerabilities in the agency. Now, more than ever, we encourage NCUA management to identify areas for self-assessment and to take corrective measures where vulnerabilities and weaknesses are identified.

We remain confident that we will continue to receive the accustomed excellent support and cooperation from the Board and senior management even as, due to limited resources and the impact of MLRs, there are issues we consider significant but do not expect to address in the next reporting period.

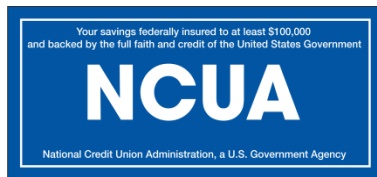
A handwritten signature in black ink that reads "William A. DeSarno". The signature is written in a cursive, flowing style.

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

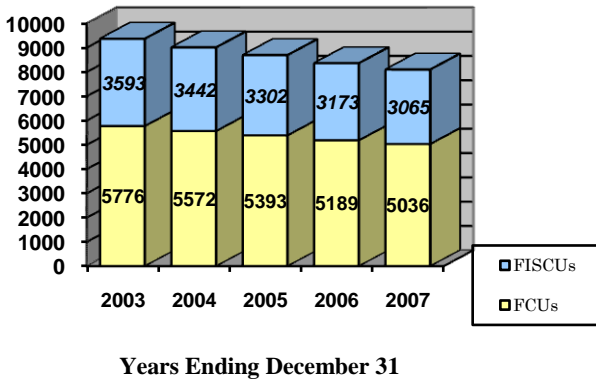
The OIG promotes the economy, efficiency, and effectiveness of NCUA programs and operations, and detects and deters fraud, waste, and abuse, thereby supporting the NCUA's mission of monitoring and promoting safe and sound federally insured credit unions.

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 June 30, 2008, the NCUA was supervising and insuring 4,956 federal credit unions and insuring 3,016 state-chartered credit unions, a total of 7,972 institutions. This represents a decline of 80 federal and 49 state-chartered institutions since December 31, 2007, for a total decline of 129 credit unions nationwide, primarily as a result of mergers.

Federally Insured Credit Unions

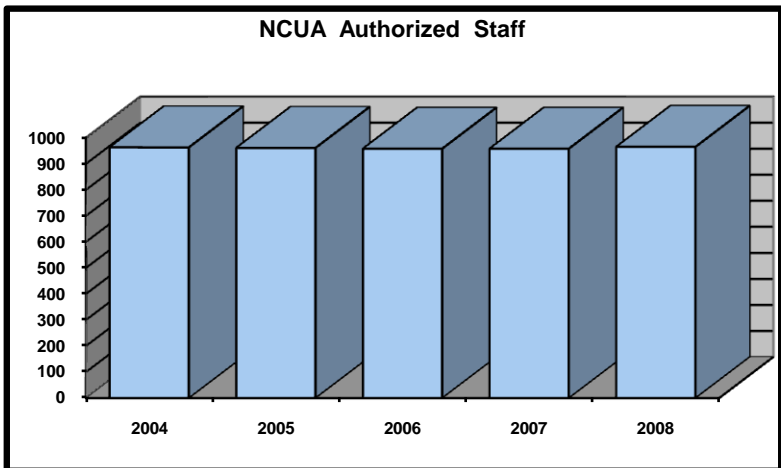
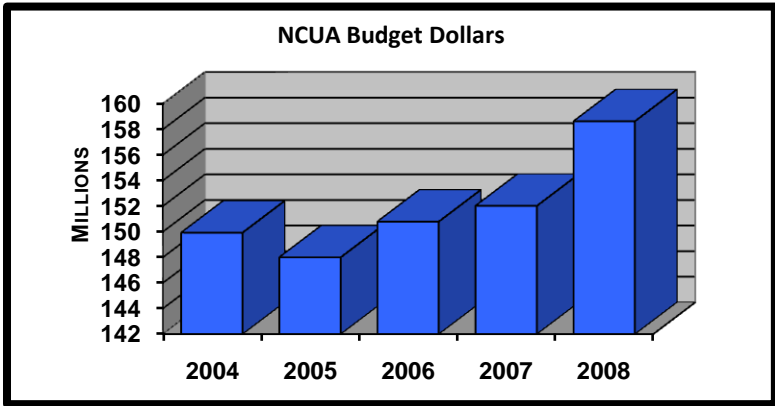


The NCUA operates under the direction of a Board composed of three members. Board members are appointed by the President and confirmed by the Senate. They serve six-year terms. Terms are staggered, so that one term expires every two years. The Board is responsible for the management of the National Credit 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 below.



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.



NCUA HIGHLIGHTS

MICHAEL E. FRYZEL SWORN IN AS NCUA CHAIRMAN, APPOINTS SARAH D. VEGA CHIEF OF STAFF AND SENIOR POLICY ADVISOR

On July 29, 2008, Michael E. Fryzel became Chairman of the NCUA. Chairman Fryzel's experience with credit unions spans many years in the public and private sector. He served as Director of the Illinois Department of Financial Institutions in the 1980s, and has represented many credit unions during the intervening years practicing law in Chicago. In addition, Mr. Fryzel is a 17-year member of the Illinois Governor's Board of Credit Union Advisors. His NCUA Board term will expire August 2, 2013.

Effective September 10, 2008, Chairman Fryzel appointed Sarah D. Vega, of Chicago, Illinois, as his Chief of Staff and Senior Policy Advisor. Ms. Vega will advise the Chairman on the full range of issues before the NCUA and oversee the day-to-day management of his office. Ms. Vega comes to NCUA following 15 years of public service in Illinois, in addition to experience in the private practice of law.

PRESIDENT BUSH SIGNS THE EMERGENCY ECONOMIC STABILIZATION ACT

On October 3, 2008, President Bush signed into law the "Emergency Economic Stabilization Act," which includes significant and beneficial legislative changes for credit unions. The legislation, combined with the previous week's enactment of the bill that removed the CLF borrowing cap, provides NCUA assistance in mitigating some of the current and potential difficulties facing the credit union industry. In addition to the highly-publicized increase in share insurance coverage to \$250,000 through December 31, 2009, the Act includes last minute changes recommended by NCUA. Specifically, the final version of the Act incorporates language that allows the National Credit Union Share Insurance Fund (NCUSIF) insurance level to

be increased while recognizing the unique elements of the Fund that make it different from FDIC. The Act also provides for NCUA to act in a consultative role with other regulators in determining how the Troubled Asset Repurchasing Program (TARP) will work. NCUA's role in TARP will enable it to have input on the rules under which assets are accepted by the federal government.

PRESIDENT BUSH SIGNS INTO LAW CONTINUING RESOLUTION WITH INCREASE TO CENTRAL LIQUIDITY FACILITY LENDING LIMIT

On September 30, 2008, President Bush signed into law the Continuing Resolution that contained a provision increasing the Central Liquidity Facility's (CLF) lending cap from \$1.5 billion to \$41.5 billion. The increase will ease corporate credit union liquidity pressures as the CLF now has significantly greater lending capacity to make loans to eligible credit unions in lieu of credit unions borrowing from their corporate credit union.

Chairman Fryzel stated that “[t]he careful case that [NCUA] built in asking for the authority was based on the concept that I wanted to be proactive and preventative, rather than reactive during a crisis, and I commend Congress for providing NCUA with an additional tool with which to address liquidity needs that may develop.”

NCUA INITIATIVES RESPOND TO MEMBER INSURANCE QUESTIONS

In late September, NCUA initiated a three-pronged approach to ensure that members of federal and most state-chartered credit unions are aware their accounts are insured by NCUA and backed by the full faith and credit of the U.S. Government.

The three initiatives that commenced on September 30, 2008, included:

- Chairman Michael E. Fryzel's assurance to credit union CEOs via video that federal insurance remains safe and secure. He encouraged CEOs to assuage member

- concerns and encouraged use of available tools, such as the NCUA's electronic Insurance Tool Kit, to help members understand their federal insurance protection.
- NCUA's distribution of three large posters to each federally insured credit union to post in the lobby, as well as making the poster available to download for electronic use. The vivid red, white, and blue "Uncle Sam" poster is designed to ensure members understand "This Credit Union Is Federally Insured."
 - A media campaign kick-off with the placement of similarly themed "Uncle Sam" advertisements in many of the nation's major newspapers, to assure credit union members and the general public that most credit union member accounts are federally insured.

BOARD MEMBER GIGI HYLAND HOSTS WEBINAR COVERING FUNDAMENTALS OF SHARE INSURANCE

As part of NCUA's initiative to ensure that members of federal and most state-chartered credit unions are aware their accounts are insured by NCUA and backed by the full faith and credit of the U.S. Government, on October 7, 2008, NCUA Board Member Hyland hosted a webinar, *Share Insurance 101*, covering the fundamentals of share insurance. The webinar drew over 3,300 participants, and provided a basic review of federal share insurance regulations as well as a discussion of available resources and operational considerations. An interactive Q&A session was an integral part of the presentation.

Frank Kressman, one of the NCUA attorneys responsible for drafting share insurance regulations, and Robert Leonard, an insurance expert within the Office of Examination and Insurance, participated in the Webinar. They focused their presentations on public confidence, public awareness, and "economic challenges."

Kressman discussed legal and regulatory requirements, including an explanation of coverage on different types of accounts and how to structure accounts to gain additional coverage. Addressing operational requirements, Leonard

explained the origination, health and stability of the NCUSIF, as well as reputation and compliance risks associated with it.

NCUA ACTIVATES DISASTER ASSISTANCE IN RESPONSE TO HURRICANE IKE

In September 2008, NCUA activated its disaster relief policy to assist credit unions and their members affected by Hurricane Ike in Texas and Louisiana. President Bush had declared that a disaster emergency existed and ordered federal aid to supplement state and local response efforts in these states.

Under its disaster assistance policy, NCUA, where necessary:

1. Encourages credit unions to make loans with special terms and reduced documentation to affected members;
2. Reschedules routine examinations of affected credit unions, if necessary;
3. Guarantees lines of credit for credit unions through the NCUSIF; and
4. Makes loans to meet the liquidity needs of member credit unions through the CLF.

During disaster conditions, NCUA personnel operate under three priorities:

- Determine the safety of credit union staff and operational condition of credit unions;
- Provide needed material and technical assistance to affected credit unions; and
- Return credit unions to normal operations as quickly as possible.

On September 11, 2008, NCUA issued a public service announcement to alert credit union members in the path of Hurricane Ike of assistance available to access their funds.

NCUA VICE CHAIRMAN HOOD HOSTS HIS SECOND ANNUAL RISK MITIGATION SUMMIT

On August 7, 2008, NCUA Vice Chairman Rodney E. Hood hosted his second annual Risk Mitigation Summit at the Federal Reserve Bank of Chicago. The event was filled with leaders from government and industry who discussed the latest and most effective techniques for risk mitigation.

Vice Chairman Hood stressed the necessity for NCUA and the industry, especially in the current economic climate, to proactively address risk mitigation issues. "Safety and soundness and consumer empowerment are closely related concepts," noted Vice Chairman Hood. The Vice Chairman reiterated his "core belief that credit unions must have regulatory flexibility and empowerment to dynamically manage their balance sheet to respond to the challenges of the current economic stresses."

The summit featured sessions which included a focus on an overview of risk management by the Federal Reserve; interest and credit; reputation risk; the Community Development Financial Institutions Fund; operational risk; and credit union risk trends. Vice Chairman Hood encouraged the audience not to simply avoid risks, but to manage them effectively in order to stimulate economic growth.

NCUA LIQUIDATES STERLENT AND CAL STATE 9 CREDIT UNIONS; PATELCO CREDIT UNION PURCHASES AND ASSUMES CREDIT UNION ASSETS

On July 1, 2008, NCUA liquidated two state chartered California credit unions, Sterlent Credit Union of Pleasanton and Cal State 9 Credit Union of Concord. Patelco Credit Union purchased assets and assumed most shares of both institutions.

In the case of Sterlent Credit Union, the California Department of Financial Institutions agreed that the NCUA would serve as liquidating agent of Sterlent. Immediately following the issuance of the order, NCUA liquidated Sterlent and entered into an

agreement with Patelco to sell certain assets and liabilities of Sterlent to Patelco. At the time of liquidation, Sterlent Credit Union had approximately \$94.6 million in assets. Sterlent was established in 1936 as EBTEL Federal Credit Union and became a California state chartered credit union in 2002.

The Cal State 9 liquidation and purchase and assumption by Patelco had been announced May 22, 2008, and was completed on July 1. Cal State 9 had been operating under NCUA conservatorship since November 2007. Chartered in 1948, Cal State 9 was originally chartered to serve University of California employees. It had assets of \$339 million and served nearly 29,000 members. The NCUA Office of Inspector General will conduct a Material Loss Review of Cal State 9 in late 2008 and early 2009.

Members of the two liquidated credit unions experienced no interruption of credit union service as their credit unions were purchased by Patelco. Patelco will continue operating branches of both purchased credit unions, and member accounts in all involved credit unions are insured by the NCUSIF.

Patelco is a state-chartered, federally insured institution that was chartered in 1936. It is a full service, \$4.1 billion credit union with more than 242,000 members primarily located in California.

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, 2008, 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 June 30, 2008 quarterly statistics for major balance sheet items and key ratios shows the following for the nation's 7,972 federally insured credit unions: assets grew 6.51 percent; net worth to assets ratio decreased from 11.43 to 11.04 percent; the loan to share ratio decreased from 83.32 percent to 80.72 percent; the delinquency ratio increased from .93 to .97 percent; and credit union return on average assets decreased from .64 percent to .52 percent.

SAVINGS SHIFTING TO MONEY MARKET ACCOUNTS

Total insured share accounts increased 7.03 percent. Money market shares increased 13.86%. Regular shares comprise 26.98 percent of total share accounts; share certificates comprise 32.84 percent; money market shares comprise 18.70 percent; and share draft accounts comprise 11.13 percent; and all other share accounts comprise 10.35 percent.

LOANS INCREASED

Loan growth of 3.69 percent resulted in an increase in total loans by \$19.45 billion. Total net loans of \$542 billion comprise 68 percent of credit union assets. Real estate loans increased 11.74 percent. First mortgage real estate loans are the largest single asset category with \$198.09 billion accounting for 36.25 percent of all loans. Other real estate loans of \$92.84 billion account for 17.0% of all loans. Used car loans of \$92.03 billion were 16.84% of all loans, while new car loans amounted to \$82.15 billion or 15.04% of total loans. Credit card loans totaled \$30.56 billion or 5.59% of total loans and other loans totaled \$50.72 billion for 9.28% of total loans.

LEGISLATIVE HIGHLIGHTS

PRESIDENT BUSH SIGNS INTO LAW “EMERGENCY ECONOMIC STABILIZATION ACT OF 2008”

On October 3, 2008, President George W. Bush signed into law the “Emergency Economic Stabilization Act of 2008,” which temporarily increases federal deposit insurance coverage. The new law amends the share insurance coverage provided by NCUA through the National Credit Union Share Insurance Fund and the deposit insurance provided by the Federal Deposit Insurance Corporation (FDIC). The NCUA Board also took action on October 3 to eliminate the concept of “qualified beneficiary” in determining share insurance coverage. The newly enacted rule serves to maintain parity between insurance coverage offered by NCUA and the FDIC. NCUA is working to update all related publications to reflect these changes.

STATUARY SHARE INSURANCE CHANGE: \$250,000

The new law became effective on October 3, 2008, and will remain in place through December 31, 2009. The law provides for an increase in the minimum NCUSIF coverage from \$100,000 to \$250,000 on member share accounts. This includes all account types, such as regular share, share draft, money market, and certificates of deposit. Individual Retirement Account and Keogh account coverage remains at up to \$250,000 separate from other types of accounts owned.

The increase in the minimum share insurance coverage to \$250,000 will not result in an increase to members’ share insurance premium or operating fee. Changes will be made to the 5300 report for the December 2008 reporting cycle to address the new coverage level.

CHANGE IN NCUA RULES – “QUALIFIED BENEFICIARY”

To maintain parity with FDIC insurance coverage, the NCUA Board approved a change to Part 745.4 of the NCUA Rules and Regulations eliminating the concept of “qualified beneficiary.” Beneficiaries are now defined as natural persons as well as charitable organizations and other non-profit entities recognized as such under the Internal Revenue Code of 1986. For members with revocable trust accounts totaling no more than \$1,250,000, coverage will be determined without regard to the proportional beneficial interest of each beneficiary in the trust.

Under the amended rules, a trust account owner with up to five different beneficiaries named in all of his or her revocable trust accounts at one NCUA-insured institution will be insured up to \$250,000 per beneficiary. Revocable trust account owners with more than \$1,250,000 and more than five different beneficiaries named in the trust(s) will be insured for the greater of either: \$1,250,000 (5 X \$250,000) or the aggregate amount of all the beneficiaries’ interests in the trust(s), limited to \$250,000 per beneficiary.

PRESIDENT BUSH SIGNS INTO LAW CONTINUING RESOLUTION WITH INCREASE TO CENTRAL LIQUIDITY FACILITY LENDING LIMIT

On September 30, 2008, President Bush signed into law a government funding resolution that also contains a borrowing cap increase for NCUA's Central Liquidity Facility (CLF) for Fiscal Year 2009. The increased borrowing ceiling was included in a continuing resolution to keep the government funded into 2009. The CLF provision temporarily lifts an arbitrary \$1.5 billion lending cap placed on the NCUA's liquidity facility. The increased cap will allow the CLF to lend up to approximately \$41.5 billion to the credit union system.

PRESIDENT BUSH SIGNS INTO LAW “INSPECTOR GENERAL REFORM ACT OF 2008”

On October 14, 2008, President Bush signed into law the “Inspector General Reform Act of 2008,” P.L. 110-409. The law was designed to guarantee that a forum exists for Inspectors General (IGs) to coordinate and share best practices; that IGs remain independent from

inappropriate influence or pressure from the government agencies they oversee; and that IG reports are easily accessible to the public.

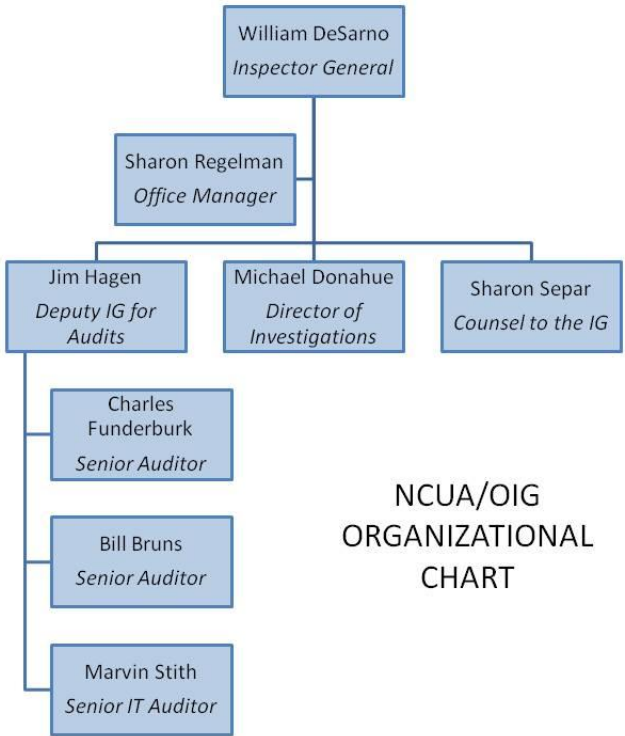
The legislation was introduced last year in the Senate by Senators Claire McCaskill (D-Missouri), Susan Collins (R-Maine), and Joe Lieberman (I-Connecticut). Congressman Jim Cooper (D-Tennessee) introduced similar legislation in the House of Representatives. After the Senate and the House passed their respective bills earlier this year, legislators from both chambers worked together to negotiate a compromise and agree on identical language for the bill that was, ultimately, sent to the President for signature.

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, Deputy 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.



NCUA/OIG
ORGANIZATIONAL
CHART

AUDIT ACTIVITY

AUDIT REPORTS ISSUED

MAY 21, 2008

REVIEW OF FINANCIAL ACCOUNTING SOFTWARE ACQUISITION METHODOLOGY – MEMORANDUM TO CFO

Because the NCUA plans to convert to a new agency accounting system, the OIG looked at the agency's software acquisition methodology and compared it to Federal agency acquisition best practices. Our inquiry did not constitute an audit of the agency's software acquisition methodologies. Rather, we provided a snapshot in time, covering the period March/April 2008. The observations were meant to provide NCUA best practices recommendations and assist the Chief Financial Officer (CFO) in the acquisition of a new agency accounting system.

On May 21, 2008, the Inspector General issued a memorandum to the CFO. In summary, the memorandum stated that in reviewing the agency's process to convert to a new accounting system software acquisition methodology, we observed that the Office of the Chief Financial Officer (OCFO) gathered a tremendous amount of software acquisition background information regarding various acquisition policies and procedures. However, the agency may want to consider developing a comprehensive NCUA software acquisition methodology document that includes best practices such as planning/needs assessment, and acquisition process and outcome monitoring to guide it through the acquisition process.

OIG-08-06 – June 4, 2008

REVIEW OF THE IMPLEMENTATION OF HOMELAND SECURITY PRESIDENTIAL DIRECTIVE 12

We determined NCUA made progress towards issuing Personal Identity Verification (PIV) credentials to its employees and contractor employees. NCUA verified, initiated, or completed background investigations on its employees. In addition, NCUA began initiating background investigations on its contractor employees. Furthermore, NCUA proofed

and registered its existing employees and contractor employees starting in August 2006. However, NCUA had not issued credentials to new or existing employees and contractor employees as required, and the credentials NCUA plans to issue do not meet HSPD-12 and FIPS 201 requirements. In addition, NCUA had not fulfilled other HSPD-12 requirements. Specifically, NCUA: (1) did not have an implementation plan; (2) did not have an accredited and approved identity proofing and registration process; (3) did not have an accredited and approved PIV issuance and management process; and (4) has not included language in contracts requiring compliance with HSPD-12 and FIPS 201.

We made eight recommendations where improvements could be made. Management agreed with seven of the report's recommendations and has plans or is in the process of taking corrective action to address those recommendations. Management disagreed with one recommendation related to Federal Bridge Certificate Authority because they made a business decision that they do not believe the expenditure of agency funds is justified at this time. The OIG understands the agency position.

OIG-08-07 – September 24, 2008

**OIG REPORT TO OMB ON THE NATIONAL CREDIT UNION ADMINISTRATION
SECURITY PROGRAM 2008**

This report contains a summary of our evaluation of the NCUA's information security program presented in the Office of Management and Budget (OMB) prescribed format.

The OIG issued two reports during the past year that reported on the testing of the effectiveness of information security and internal controls:

- On September 24, 2008, the OIG issued a report containing an Independent Evaluation of the NCUA's Information Security Program - 2008. The content of the independent evaluation report supports the conclusions presented in this report.
- On February 28, 2008, the OIG issued the Financial Statement Audit Report for the year ended December 31, 2007. The purpose of this audit was to express an opinion on whether the financial statements were fairly presented. In addition, the internal control structure was reviewed and an evaluation of compliance with laws and regulations was performed as part of the audit. The result of this audit was an unqualified opinion,

stating that the financial statements were presented fairly. Although there were no material weaknesses identified during the review of the internal control structures pertinent to financial reporting, several recommendations were made relating to weaknesses in the financial and information security areas.

OIG-08-08 – September 24, 2008

**INDEPENDENT EVALUATION OF THE NATIONAL CREDIT UNION
ADMINISTRATION INFORMATION SECURITY PROGRAM 2008**

The OIG engaged Grant Thornton LLP 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.

Grant Thornton evaluated NCUA's security program through interviews, documentation reviews, technical configuration reviews, social engineering testing, and sample testing. We evaluated NCUA 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 conducted an exit conference with NCUA on July 23, 2008, to discuss evaluation results.

The NCUA has worked to further strengthen its information technology (IT) security program during Fiscal Year 2008. NCUA's accomplishments during this period include:

- Implementing OMB guidance in managing Privacy and breach notifications.
- Ninety-seven percent of NCUA employees completed annual security awareness training.

We identified six areas remaining from last year's FISMA evaluation that still need improvement:

- NCUA has not adequately established segregation of duty controls for its applications.
- NCUA has not completed E-Authentication risk assessments for its systems.

- NCUA has not completed security controls testing for one of its FISMA systems.
- NCUA does not have a formal agency-wide security configuration guide.
- NCUA has not updated its employee enter/exit/change procedures.
- NCUA has not implemented continuing education requirements for its IT employees.

In addition, we identified four new findings this year where NCUA could improve IT security controls:

- NCUA's System Software Change Procedures needs improvement.
- NCUA vulnerability management needs improvement.
- NCUA lacks a comprehensive contingency planning program for its FISMA systems.
- NCUA's Plans of Action and Milestones (POA&M) process needs improvement.

AUDITS IN PROGRESS

HOME MORTGAGE DISCLOSURE ACT DATA ANALYSIS REVIEW

The Office of Inspector General is initiating a review of NCUA's Home Mortgage Disclosure Act (HMDA) Process. This review is part of the OIG's 2008 Performance Plan. The objective of our survey review is to determine what NCUA is doing to ensure that HMDA data is used and followed-up on to prevent instances of possible discriminatory lending practices. One of the purposes of the HMDA is to assist financial regulators in identifying possible discriminatory lending patterns and enforcing compliance with anti-discriminatory statutes. Under NCUA's Risk Focused Examination System, examiners exercise judgment in developing variable scope procedures to determine the risk or existence of discriminatory lending. Examiners are considering such factors as HMDA data, credit union member complaints, prior examination concerns, lending program complexity, and credit union field of membership when determining what examination procedures will be performed. In addition, separate fair lending examinations may be performed in credit unions by NCUA consumer compliance subject matter examiners.

MATERIAL LOSS REVIEWS OF HURON RIVER, NORLARCO AND CAL STATE 9

The FCU Act provides that a review is required when the NCUSIF incurs a material loss. For purposes of determining whether the NCUSIF has incurred a material loss with respect to an insured credit union such that the OIG 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 NCUA Board initiated assistance under section 208, or was appointed liquidating agent.

On February 1, 2008, the OIG was notified by NCUA that the losses incurred by two credit unions (Huron River Area Credit Union and Norlarco) had exceeded the statutory requirements, triggering a material loss review by the OIG. On August 13, 2008, the OIG was notified by NCUA that Cal State 9 credit union losses had exceeded the statutory requirements, also 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 state and/or NCUA 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.

SIGNIFICANT AUDIT RECOMMENDATIONS ON WHICH CORRECTIVE ACTION HAS NOT BEEN COMPLETED

As of September 30, 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 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 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 178 consumer complaints to regional offices. The OIG referred six allegations of potential fraud at credit unions to the Office of General Counsel.

INVESTIGATIONS

ABUSE OF AUTHORITY

During this reporting period, the OIG received an allegation that an NCUA examiner had abused his authority and engaged in an inappropriate relationship with a credit union employee. Specifically, the complaint alleged that the employee misused his government position to access private financial data about his neighbors. Moreover, the allegation also included information the employee threatened his ex-wife by using his influence to place a judgment on her credit report. The OIG initiated an investigation and concluded the examiner violated the *Standards of Ethical Conduct for Employees of the Executive Branch* by using his official position for private gain and using nonpublic information for private gain. The matter was referred to management for appropriate disciplinary action.

VIOLATION OF OPM POLICIES

The OIG developed information that the agency violated Office of Personnel Management (OPM) regulations when it issued a cash award directly to an employee detailed to NCUA from another government agency. Based on our review of the relevant materials and the circumstances surrounding the issue, the OIG determined the agency knowingly violated OPM administrative regulations governing cash awards. While OPM assigns no specific penalties for violating its procedures, the OIG advised the agency of its potential vulnerability to criticism from OPM if the issue were brought to light during an OPM review of the agency's compliance with administrative policies and regulations. The OIG briefed management on its findings and provided a copy of the applicable regulation to ensure future compliance.

U.S. SMALL BUSINESS ADMINISTRATION REFERRAL

The U.S. Small Business Administration (SBA) Office of the National Ombudsman referred to the OIG an allegation concerning two examiners who allegedly abused their authority and engaged in retaliatory practices

against a credit union after questions were raised with regard to an examination. The OIG conducted a preliminary inquiry into the matter and did not develop substantive information to warrant further investigation.

PROACTIVE INITIATIVES

During this reporting period, the OIG launched several proactive initiatives designed to identify areas of potential vulnerability in agency programs and operations. These areas involved the agency's *gift card*, *purchase card*, and *travel card* programs. The OIG worked with the NCUA Office of the Chief Financial Officer (OCFO) and the Office of Human Resources (OHR) in these efforts. These reviews resulted in the OIG issuing recommendations to lessen the potential for waste, fraud and abuse. The travel card program review also identified an employee who used his government contractor-issued agency travel card to make thousands of dollars of unauthorized purchases unrelated to official agency business. The OIG referred the matter to management for appropriate disciplinary action which resulted in a three day suspension without pay.

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 20 items, including proposed and final legislation and regulations, comments to proposed regulations, and agency Interpretive Rulings and Policy Statements (IRPS). We issued formal comments on one legislative item, H.R. 5683.

SUMMARY OF STATUTES AND REGULATIONS REVIEWED	
Legislation	Title
H.R. 1424	"Emergency Economic Stabilization Act of 2008"
H.R. 928, S. 2324 (P.L. 110-409)	"Inspector General Reform Act of 2008"
H.R. 1424	"Emergency Economic Stabilization Act of 2008"
H.R. 5683	"Government Accountability Office Act of 2008"
S. 789	"Government Credit Card Abuse Prevention Act of 2008"
H.R. 1395	"Government Credit Card Abuse Prevention Act of 2007"
S. 3077, H.R. 6411	"Strengthening Transparency and Accountability in Federal Spending Act of 2008"
S. (Staff Draft)	"Federal Information Infrastructure Response Act of 2008 (the FIIRE Act of 2008)"
S. 2583	"Improper Payments Elimination and Recovery Act of 2008"

Regulations/Rulings	Title
H.R. 6639	"Federal Agency Performance Review And Efficiency Act"
H.R. 6575	"Over-Classification Reduction Act"
12 CFR Part 706	Joint Proposed Rulemaking Regarding Unfair or Deceptive Acts of Practices
12 CFR Part 721	Final Rule: "Incidental Powers"
12 CFR Part 792	Final Rule: "Revisions for the Freedom Of Information Act and Privacy Act Regulations"
12 CFR Part 701 and 705	Final Rule: "The Low Income Definition"
12 CFR Part 740	Final Rule: "The Official Advertising Statement"
12 CFR Part 723	ANPR: "Member Business Loans (MBL)"
5 CFR Parts 2637 and 2641	Final Rule: "Post Employment Conflict Of Interest Restrictions"
IRPS 08-01	Final Interpretative Ruling and Policy Statement 08-01: "Guidance Regarding Prohibitions Imposed by Section 205(d) of the Federal Credit Union Act"
IRPS 08-02	Proposed Interpretative Ruling and Policy Statement 08-02: "Updating and Clarifying Criteria for Approval to Serve An 'Underserved Area'"

**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, 2008

PART I – AUDIT REPORTS ISSUED		
Report Number	Title	Date Issued
N/A	Review of Financial Accounting Software Acquisition Memorandum	05/21/2008
OIG-08-06	Review of the Implementation of Homeland Security Directive 12	06/04/2008
OIG-08-07	OIG Report to OMB on the National Credit Union Administration Security Program 2008	09/24/2008
OIG-08-08	Independent Evaluation of the National Credit Union Administration Information Security Program 2008	09/24/2008
PART II – AUDITS IN PROGRESS <i>(as of September 30, 2008)</i>		
	Home Mortgage Disclosure Act Data Analysis review	
	Material Loss Reviews of Huron River, Norlarco, and Cal State 9	

INDEX OF REPORTING REQUIREMENTS

SECTION	DATA REQUIRED	PAGE REF
4(a)(2)	Review of Legislation and Regulations	26
5(a)(1)	Significant Problems, Abuses, or Deficiencies Relating to the administration of programs and Operations disclosed during the reporting period.	17
5(a)(3)	Recommendations with Respect to Significant Problems, Abuses, or Deficiencies.	17
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.	30
5(a)(7)	Summary of Particularly Significant Reports.	17
5(a)(8)	Statistical Tables on Audit Reports With Questioned Costs.	28
5(a)(9)	Statistical Tables on Audit Reports With Recommendations That Funds Be Put To Better Use.	29
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

NCUA

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NATIONAL CREDIT UNION ADMINISTRATION

OFFICE OF THE INSPECTOR GENERAL

P.O. BOX 25705

ALEXANDRIA, VA 22313-5705

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