



# Semiannual Report To the Congress

October 1, 2016 – March 31, 2017





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## A MESSAGE FROM THE INSPECTOR GENERAL

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On behalf of the Office of Inspector General (OIG) of the National Credit Union Administration (NCUA), I am pleased to present our Semiannual Report to the NCUA Board and the Congress highlighting our accomplishments and ongoing work for the six-month period ending March 31, 2017. Our work reflects the legislative mandate of the *Inspector General Act of 1978, as amended*, 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 that cause as well as our goal of enhancing public confidence in the regulatory process.

On the audit side, we issued a Material Loss Review report related to the failure of six credit unions in the Philadelphia area. We determined these credit unions failed due to overstatement of approximately \$3.2 million in assets, primarily investments in certificates of deposit, allegedly due to fraud. As a result of our review, we made two recommendations to NCUA management aimed at strengthening oversight in the Supervisory Committee Audit process and clarifying examination procedures related to NCUA's Small Credit Union Examination Program.

Also on the audit side, the Digital Accountability and Transparency Act of 2014 (DATA Act), requires Inspectors General to conduct a series of oversight reviews due in November 2017, 2019, and 2021. We conducted a readiness review of NCUA to gain an understanding of the processes, systems, and controls that NCUA has implemented or plans to implement to report financial and payment data in accordance with the requirements of the DATA Act. The results of this review are highlighted in the body of this semiannual report.

During this reporting period we also issued a comprehensive report on NCUA's information security program in accordance with the *Federal Information Security Modernization Act of 2014* (FISMA). Consistent with FISMA's requirements, we performed an annual independent evaluation of NCUA's information security program and practices. In the FISMA report, we highlighted steps that the agency could take to improve the security of its information resources.

On the investigative side, the Office of Investigations (OI) opened one case during the reporting period. I want to thank our long time Director of Investigations, Mike Egan. Mike retired in February 2017 after 30 distinguished years of federal service.

Finally, I would like to thank Acting Chairman McWatters and Board Member Metsger for their sustained support of the OIG's work. As in the past, the NCUA Board and management have been



responsive in attempting to implement all OIG recommendations. I appreciate management's support and I look forward to working with them in our ongoing efforts to promote economy and efficiency in agency programs.

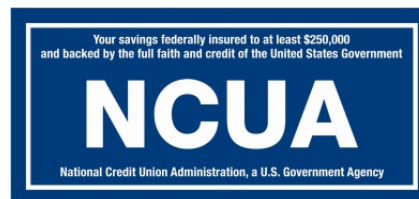
A handwritten signature in black ink, appearing to read "James W. Hagen".

James W. Hagen  
Inspector General

## THE NATIONAL CREDIT UNION ADMINISTRATION MISSION

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



## THE OFFICE OF INSPECTOR GENERAL MISSION

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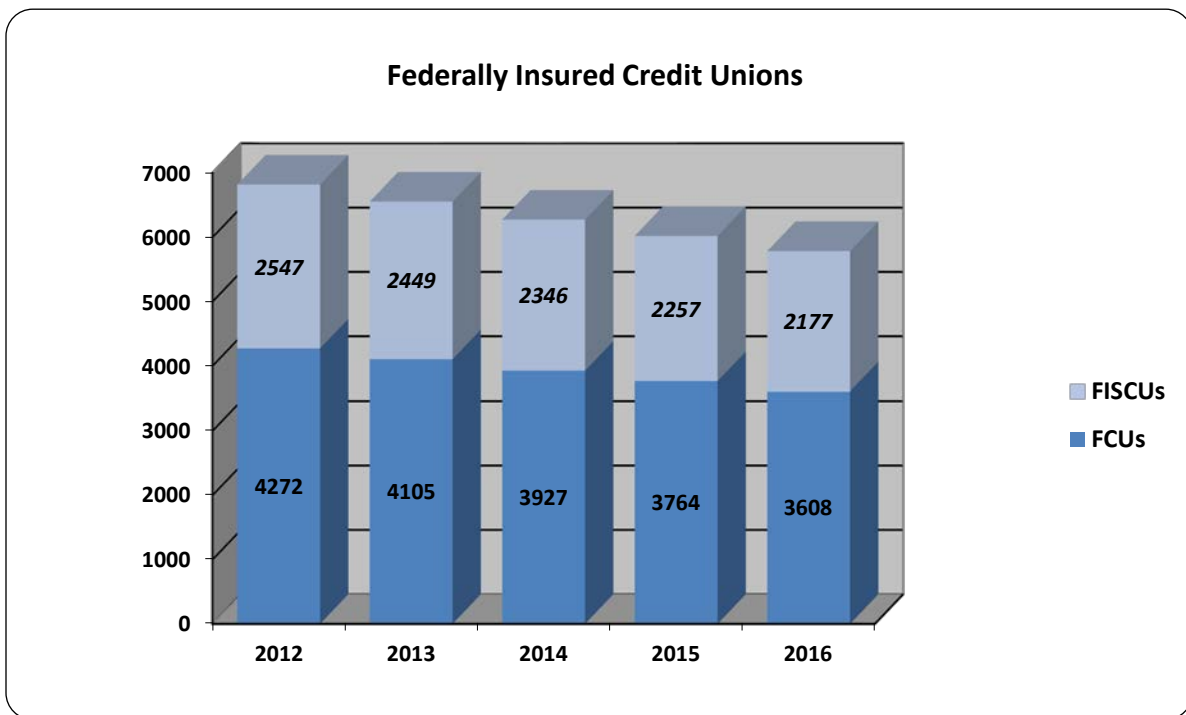
The Office of Inspector General (OIG) promotes the economy, efficiency, and effectiveness of NCUA programs and operations, and detects and deters fraud, waste, and abuse, thereby supporting NCUA's mission of monitoring and promoting safe and sound federally insured credit unions.

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**

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. NCUA is funded by the credit unions it supervises and insures. As of December 31, 2016, NCUA was supervising and insuring 3,608 federal credit unions and insuring 2,177 state-chartered credit unions, a total of 5,785 institutions. This represents a decline of 156 federal and 80 state-chartered institutions since December 31, 2015, for a total decrease of 236 credit unions nationwide, primarily as a result of mergers and liquidations.

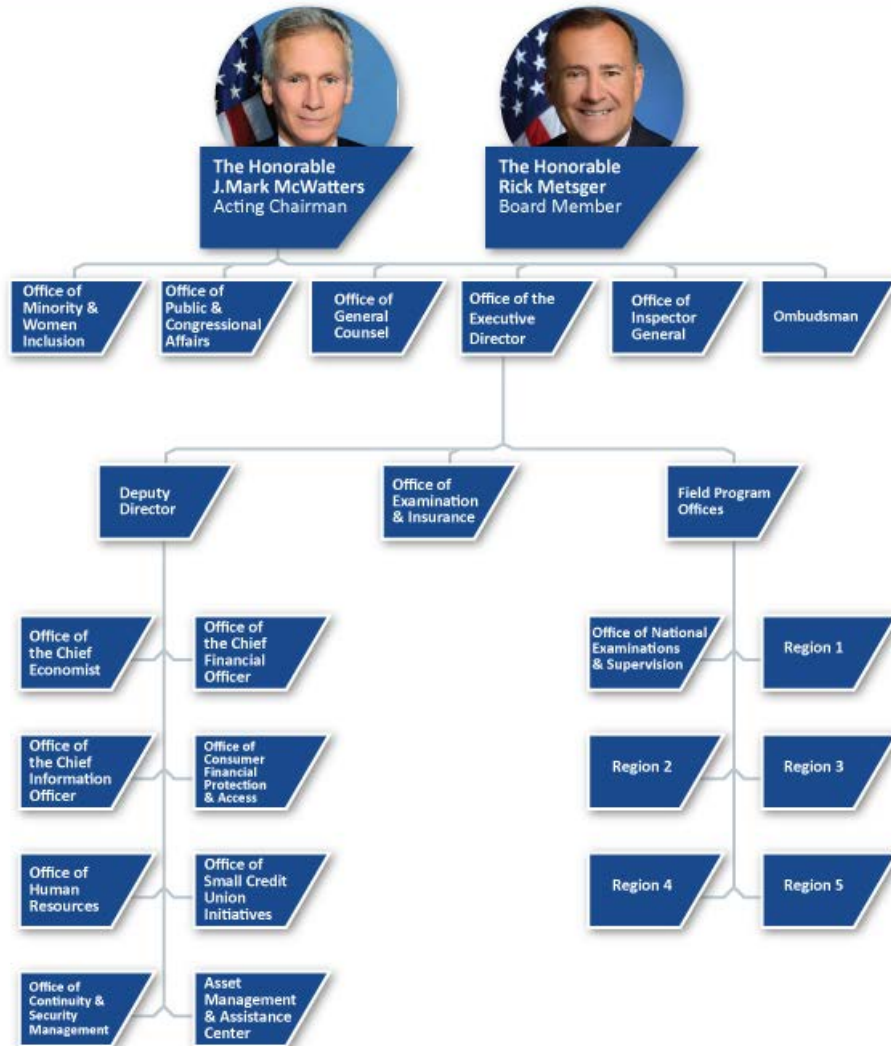


NCUA operates under the direction of a Board composed of three members. Board members are appointed by the President and confirmed by the Senate. They serve six-year terms. Terms are staggered, so that one term expires every two years. The Board is responsible for the management of NCUA, including the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



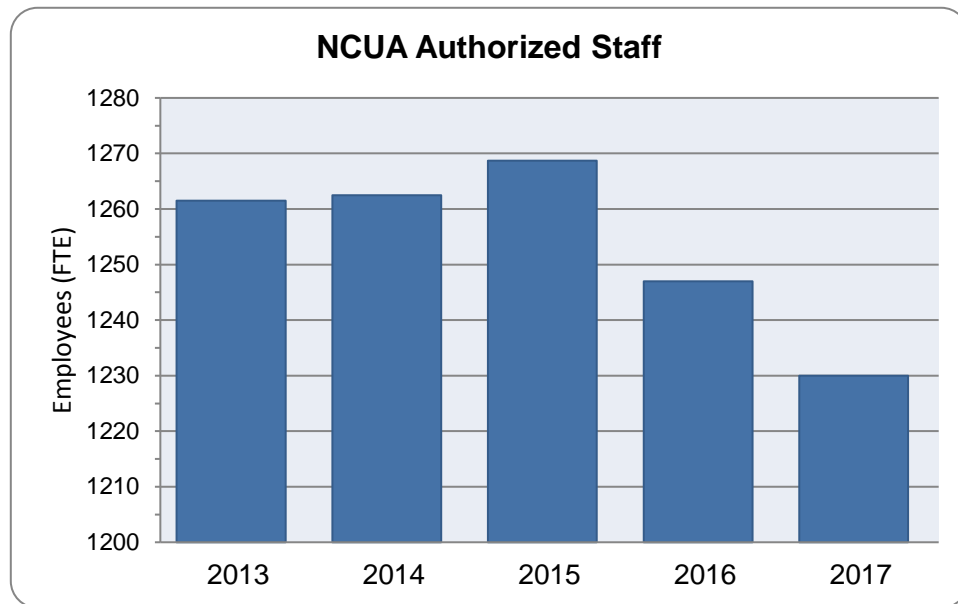
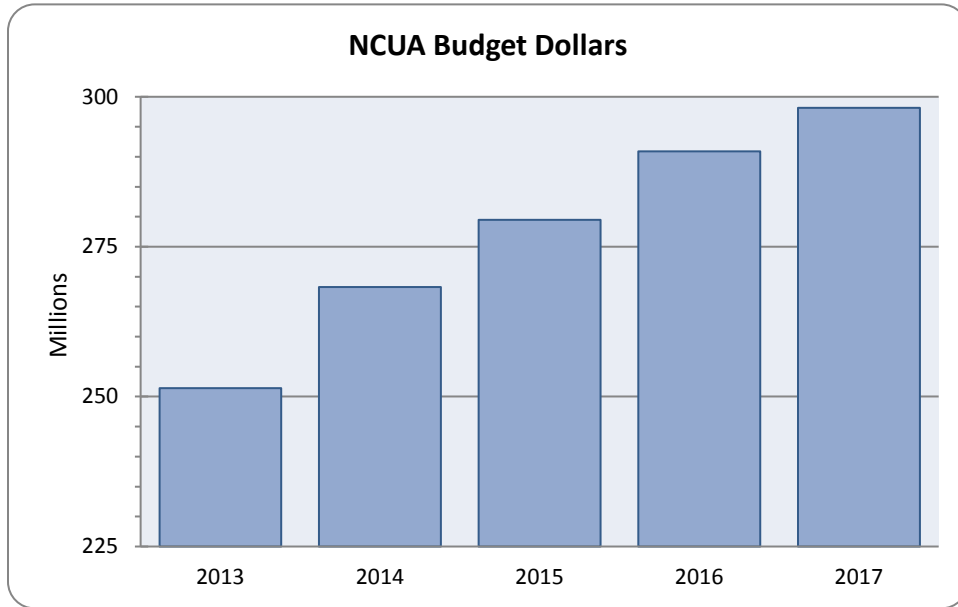
NCUA executes its program through its central office in Alexandria, Virginia and regional offices in Albany, New York; Alexandria, Virginia; Atlanta, Georgia; Austin, Texas; and Tempe, Arizona. NCUA also operates the Asset Management and Assistance Center (AMAC) in Austin, Texas. Please refer to NCUA’s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

## National Credit Union Administration Organizational Chart





NCUA’s Board adopted its 2017 budget of \$298,164,000 on November 16, 2016. The Full-Time Equivalent (FTE) staffing authorization for 2017 is 1,230 representing a decrease of 17 FTE from 2016.







## NCUA HIGHLIGHTS

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### **Foster Selected as Director of Public and Congressional Affairs Director**

On March 20, 2017, Robert U. Foster was selected as Director of NCUA's Office of Public and Congressional Affairs (PACA). Prior to Mr. Foster's selection he served as NCUA's Deputy Director of PACA from 2008 to 2011 and Legislative Director to Senator Roger F. Wicker (R-Miss.). He also served as Deputy Assistant Secretary, Office of Legislative Affairs, at the U.S. Treasury Department; as Staff Director of the House Committee on Financial Services; and as Legislative Director and Senior Policy Advisory to the late Congressman Michael G. Oxley (R-Ohio). Mr. Foster holds a bachelor's degree in economics from Virginia Polytechnic Institute and State University.

### **NCUA's Four Permanent Funds Earns Clean Audit Opinions for 2016**

In February 16, 2017, NCUA received unmodified or "clean" opinions for its four permanent funds in its financial statements audited by the independent accounting firm KPMG LLP. The four permanent funds are the Share Insurance Fund, the Agency's Operating Fund, the Central Liquidity Facility, and the Community Development Revolving Loan Fund.

The Share Insurance Fund held more than \$12.8 million in total assets as of December 31, 2016. This Fund protects member deposits up to \$250,000 for more than 106 million consumers at more than 5,700 federally insured credit unions.

### **McWatters Named Acting NCUA Chairman**

On January 26, 2017, NCUA announced that President Donald J. Trump designated Board Member J. Mark McWatters as the Acting Chairman of the NCUA Board. Mr. McWatters was nominated to the NCUA Board by then-President Barack Obama on January 7, 2014, with Senate confirmation and took office as a NCUA Board Member on August 26, 2014. He succeeds Rick Metsger, who was designated Board Chairman in May 2016 and continues to serve as an NCUA Board Member.

### **NCUA Approves 2017-2018 Budget with Exam Flexibilities Initiative Recommendations**

On November 17, 2016, the NCUA Board unanimously approved two items: (1) the operating budgets for 2017 and 2018 to fund NCUA's essential activities and strategic priorities, including implementing the recommendations of the Exam Flexibility Initiative; and (2) a final rule making technical changes to the agency's Community Development Revolving Loan Fund regulation to improve transparency, organization, and ease of use by credit unions.

The 2017 and 2018 budgets reflect reduced staffing levels while maintaining critical agency capacity. The 2017 operating budget is 1.6 percent lower than the 2017 budget approved by the



Board in November 2015 and 2.5 percent higher than the 2016 budget. The 2018 operating budget represents a 4.7 percent increase over the 2017 budget. The decrease in staffing in 2017 and 2018 will be a result of attrition. NCUA's total staffing will fall by 1.4 percent in 2017 and 1.8 percent in 2018.

NCUA plans to make recommendations to the Board on the overhead transfer rate early in 2017. The Board plans to continue the practice of performing mid-year budget reviews.

### **Nomura to Pay \$3 Million Settlement for NCUA Securities Claims**

On November 2, 2016, NCUA announced that Nomura Asset Acceptance Corporation and Nomura Home Equity Loan, Inc. agreed to pay more than \$3 million dollars to settle claims by NCUA alleging the sale of faulty residential mortgaged-backed securities to two corporate credit unions.

As liquidating agent for Western Corporate Federal Credit Union and U.S. Central Federal Credit Union, the NCUA Board settlement covers claims asserted in 2011. With this settlement, NCUA will dismiss any pending suits against both firms. Neither firm admitted fault as part of the settlement.

NCUA was the first financial institution to recover losses from investments in securities on behalf of financial institutions that failed during the recent financial crisis. The Federal Credit Union Act and NCUA regulations require that net proceeds from recoveries be used to pay claims against the failed corporate credit unions, including those of the Temporary Corporate Credit Union Stabilization Fund.

### **NCUA Plans to Repay Treasury in Full**

On October 18, 2016, NCUA announced its plan to fully repay \$1 billion of an outstanding balance it borrowed from the U.S. Treasury. NCUA has a \$6 billion dollar borrowing line from the Temporary Corporate Credit Union Stabilization Fund with Treasury to satisfy any future agency contingent funding needs, including obligations of the NCUA Guaranteed Notes (NGN) Program. With the repayment, NCUA will fully satisfy this borrowing line.

Even though NCUA will repay the \$1 billion, no funds will be immediately available for rebate to federally insured credit unions of Stabilization Fund assessments. Nor will funds be available for any recoveries by investors with claims for depleted capital of the failed corporate credit unions. NCUA must first satisfy any outstanding senior obligations of the Stabilization Fund and corporate credit union asset management estates that may not be realized until 2021.

## **FEDERALLY INSURED CREDIT UNION HIGHLIGHTS**

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Credit unions submit quarterly call reports (financial and operational data) to NCUA. An NCUA staff assessment of the December, 31, 2016, quarterly call reports submitted by all federally insured credit unions found that key financial indicators are positive.

### **Key Financial Indicators Favorable**

Looking at the December 31, 2016, quarterly statistics for major balance sheet items and key ratios shows the following for the nation's 5,785 federally insured credit unions: assets grew 7.3 percent; net worth to assets ratio decreased from 10.92 to 10.89 percent; and the loan to share ratio increased from 77.5 percent to 79.5 percent. The delinquency ratio increased from .81 to .83 percent. Credit union return on average assets increased from .75 to .77 percent.

### **Savings Shifting to Regular Shares**

Total share accounts increased 7.54 percent. Regular shares increased 11.85 percent. Regular shares comprise 36.03 percent of total share accounts; share certificates comprise 18.26 percent; money market shares comprise 22.81 percent; share draft accounts comprise 14.07 percent; IRA/KEOGH accounts comprise 7.15 percent; nonmember deposits comprise .80 percent; and all other share accounts comprise .89 percent.

### **Loan Volume Increasing**

Loans increased 10.43 percent resulting in an increase in total loans by \$82.09 billion. Total net loans of \$861.30 billion comprise 66.64 percent of credit union assets. First mortgage real estate loans are the largest single asset category with \$354.04 billion accounting for 40.74 percent of all loans. Other real estate loans of \$77.03 billion account for 8.86 percent of all loans. Used car loans of \$181.84 billion were 20.92 percent of all loans, while new car loans amounted to \$116.86 billion or 13.45 percent of total loans. Unsecured credit card loans totaled \$52.65 billion or 6.06 percent of total loans, while all other unsecured loans totaled \$37.54 billion or 4.32 percent. Leases receivable and all other loans were \$49.15 billion or 5.65 percent of total loans.



## LEGISLATIVE HIGHLIGHTS

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### House Financial Services Committee Republicans Criticize FSOC in Report

In a staff report released on March 1, 2017, House Financial Services Committee Republicans stated that the Financial Stability Oversight Council's (FSOC) process for designating firms as systematically important financial institutions (SIFI) was "arbitrary and inconsistent." Chairman Jeb Hensarling has proposed scrapping the council's authority to label firms as SIFIs, a label that carries with it increased oversight by the Federal Reserve. Moreover, according to a committee press release, the information detailed in the staff report "clearly demonstrates the need for the accountability reforms the Committee has proposed in the [Financial CHOICE Act](#)."

Democrats defend the SIFI process as an essential tool to prevent teetering financial firms from triggering an economic crisis such as the one that occurred in 2007-2008.

FSOC has been fighting in court to defend its SIFI designation of MetLife, after it was overturned. Prudential Financial and American International Group remain SIFIs.

### Civil Monetary Penalties Adjusted for Inflation

NCUA is amending its regulations (Part 747) to adjust the maximum amount of civil monetary penalties under its jurisdiction to account for inflation.

The maximum penalty levels for 2017 are 1.6 percent higher than the maximum levels in 2016.

In order to meet the statutory deadlines for publishing inflation adjustments, the NCUA Board approved the adjustment in a notation vote on Jan. 5, and the [final interim rule](#) was posted for public comment in the *Federal Register* on January 23, 2017.

NCUA last adjusted civil monetary penalties in June 2016. Those adjustments previously had been made every four years. Congress in November 2015 changed federal law to require annual adjustments and to provide for a one-time catch-up adjustment in 2016. Agencies are required to publish their inflation adjustment rules in the *Federal Register* each year.

NCUA assesses modest civil monetary penalties on credit unions that file Call Reports late. Total penalties for the second quarter of 2016 were \$9,364. The median penalty for that quarter was \$303. The Federal Credit Union Act requires NCUA to send any funds received through civil monetary penalties to the U.S. Treasury.

## President Obama Signs the Inspector General Empowerment Act of 2016

On December 16, 2016, President Obama signed into law [H.R. 6450](#), the Inspector General Empowerment Act of 2016, a landmark piece of legislation welcomed by IGs and all advocates of government accountability and efficiency. The law enhances Inspectors General's abilities to commandeer agency documents previously held due to privacy or other concerns. The Inspector General Empowerment Act confirms that Inspectors General "are entitled to full and prompt access to agency records, thereby eliminating any doubt about whether agencies and whistleblowers are legally authorized to disclose potentially sensitive information to IGs," as noted in a statement from the Council of Inspectors General on Integrity and Efficiency (CIGIE), which had long pressed for the bill. Agencies such as the FBI and Environmental Protection Agency had cited privacy laws and national security demands as reasons for withholding some documents, a position backed by an opinion from the Justice Department's [Office of Legal Counsel](#) in July 2015.

"Passage of the IG Empowerment Act enhances the IG's ability to fight waste, fraud, abuse and misconduct, protects whistleblowers who share information with IGs, increases government transparency and bolsters the public's confidence in the independence of IGs," said Justice Department Inspector General and CIGIE Chair Michael Horowitz. "For these reasons, the act is an important milestone for good government. The inspector general community is grateful to the sponsors and co-sponsors of this act and all those who stood up for independent oversight."

## Agencies Request Comment on Proposed Private Flood Insurance Rule

On November 7, 2016, NCUA joined four other federal regulatory agencies (the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Office of the Comptroller of the Currency) in requesting comment on a joint notice of [proposed rulemaking](#) to implement provisions of the Biggert-Waters Flood Insurance Reform Act (Biggert-Waters Act) that require regulated lending institutions to accept certain private flood insurance policies in addition to policies made available by the Federal Emergency Management Agency.

The federal flood insurance statutes require regulated lending institutions to ensure that flood insurance is purchased in connection with loans secured by improved real property located in areas having special flood hazards. Under the Biggert-Waters Act, regulated lenders must accept, in satisfaction of this mandatory purchase requirement, policies issued by private insurers that satisfy the criteria specified in the Biggert-Waters Act.

The proposed rule includes provisions to assist lending institutions in identifying private flood insurance policies that they would be required to accept. The proposal also would clarify that lenders retain their discretion to accept private flood insurance policies that do not meet the criteria for mandatory acceptance, provided certain conditions are met.

Furthermore, the proposed rule would establish criteria to apply in determining that coverage offered by a mutual aid society provides the type of policy or coverage that qualifies as “flood insurance” for purposes of the federal flood insurance laws.

The agencies previously issued a proposal addressing private flood insurance (78 FR 65107). Based on comments received in response to that proposal, the agencies decided to issue this second proposal for additional public comment. NCUA received dozens of [comments](#), ranging from two to 42 pages. The problems listed by the vast majority of respondents related to how the proposed rules adversely affect credit unions and other mortgage lenders in the following areas:

- Increased liability;
- Increased cost of compliance;
- Limitations of forced-place policy reviews;
- Complete policies not available at closing;
- Commercial vs. residential; and
- Required financial ratings of insurance providers.

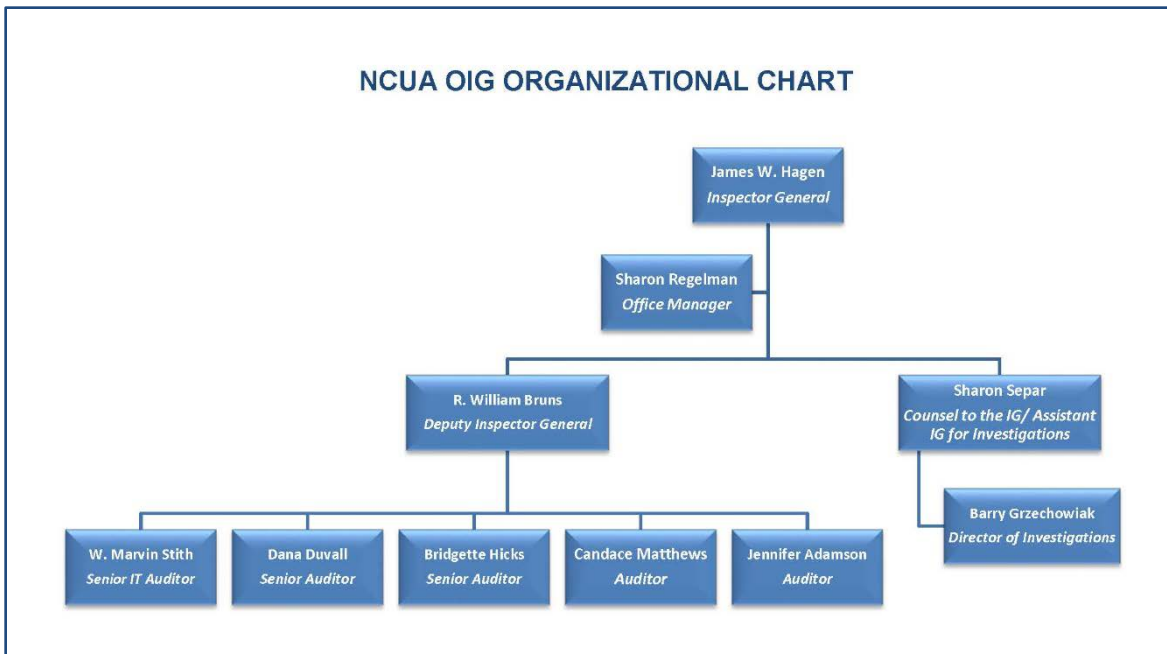
NCUA has not yet indicated when it will publish revised rules based on the comments received.

## OFFICE OF INSPECTOR GENERAL

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

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### [OIG-16-08 – FY 2016 Independent Evaluation of NCUA’s Compliance with FISMA 2014, November 10, 2016](#)

NCUA OIG contracted with the independent public accounting firm, CliftonLarsonAllen LLP (CLA) to independently evaluate NCUA’s information systems and security program and controls for compliance with the Federal Information Security Modernization Act of 2014 (FISMA).

In resolving prior year issues and recommendations, CLA determined that NCUA continued to strengthen its information security program during FY 2016. Regarding its prior year findings, NCUA made significant progress and finalized its privacy program. NCUA also made significant progress towards addressing its risk management program and has one partial finding remaining from last year pertaining to one unsupported software component that management indicates the agency will address by June 30, 2017.

With new staffing, NCUA’s Office of the Chief Information Officer conducted an extensive review of NCUA’s information security program this year. This, along with the FISMA audit, resulted in CLA identifying seven information security program areas in which NCUA needs to make improvements. As a result of CLA’s review, we made 23 recommendations which will help NCUA continue to improve the effectiveness of its information security program.

### [OIG-16-09 – Review of NCUA’s Digital Accountability and Transparency Act of 2014 Readiness, November 16, 2016](#)

The Digital Accountability and Transparency Act of 2014 (DATA Act) requires Federal agencies to report financial and payment data in accordance with data standards established by the Department of Treasury and the OMB. In addition, the DATA Act requires agency Inspectors General review statistical samples of the data submitted by the agency and report on the completeness, timeliness, quality, and accuracy of the data sampled, and the use of the data standards by the agency. The IG community undertook DATA Act “readiness reviews” at their respective agencies, in advance of the first agency report to help ensure the success of the DATA Act implementation efforts. NCUA OIG participated in this IG community effort.

To comply with the DATA Act, agencies must report, by May 2017, spending information in accordance with data standards established by OMB and Treasury. We determined that NCUA has taken the necessary steps to meet the DATA Act’s reporting deadline, determining that NCUA’s DATA Act implementation plan was consistent with both OMB requirements and Treasury’s DATA Act guidance. Although our report made no recommendations, we did determine that NCUA encountered a challenge with capturing and reporting the required data. To overcome this challenge, NCUA determined that a manual process to provide all of the required data elements would allow NCUA to report accurate and complete information.



[OIG-16-10 – Audit of NCUA’s Closing Package Schedule of Other Assets and Contributed Capital as of September 30, 2016, November 16, 2016](#)

NCUA OIG contracted with the independent accounting firm KPMG LLP to conduct the FY 2016 NCUA financial statement audit of the closing package schedule, which includes other assets and contributed capital of the NCUA as of September 30, 2016 and the related notes, for the Consolidated Financial Statements of the U.S. Government.

Under a contract monitored by NCUA OIG, KPMG performed an audit of NCUA’s closing package schedule as of September 30, 2016. KPMG conducted the audit in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 15-02, Audit Requirements for Federal Financial Statements.

KPMG’s audit report included: (1) an opinion on the closing package schedule, (2) conclusions on internal controls over the closing package schedule, and (3) compliance and other matters specific to the closing package schedule. KPMG issued an unmodified audit opinion with no reportable findings.

[OIG-17-05 – Material Loss Review of Chester Upland School Employees, O P S EMP, Electrical Inspectors, Triangle Interests % Service Center, Cardozo Lodge, and Servco Federal Credit Unions, February 23, 2017](#)

NCUA OIG contracted with Moss Adams LLP to conduct a Material Loss Review of Chester Upland School Employees Federal Credit Union, O P S EMP Federal Credit Union, Electrical Inspectors Federal Credit Union, Triangle Interests % Service Center Federal Credit Union, Cardozo Lodge Federal Credit Union, and Servco Federal Credit Union (collectively “the Credit Unions”), six federally insured credit unions. We reviewed the Credit Unions to: (1) determine the cause(s) of the Credit Unions’ failures and the resulting estimated \$3.2 million loss to the National Credit Union Share Insurance Fund; (2) assess NCUA’s supervision of the Credit Unions; and (3) provide appropriate suggestions and/or recommendations to prevent future losses.

We determined the Credit Unions failed due to overstatement of approximately \$3.2 million in assets, primarily investments in certificates of deposit, allegedly due to fraud. Specifically, we determined that questionable management integrity and performance, weak supervisory committee oversight, and weak oversight by the board of directors were all factors that created an environment in which the overstatement of assets went undetected. We made two recommendations to NCUA management related to strengthening oversight in the Supervisory Committee Audits and clarifying examination procedures related to NCUA’s Small Credit Union Examination Program.

### [OIG-17-06 – FY 2016 Financial Statement Audits \(TCCUSF\), February 28, 2017](#)

The Temporary Corporate Credit Union Stabilization Fund (TCCUSF) is a revolving fund in the U.S. Treasury established in 2009 under the management of the NCUA Board. The purposes of the TCCUSF are to accrue the losses of the corporate credit union system and, over time, assess the credit union system for the recovery of such losses. During 2016, the financial condition of the TCCUSF improved, as seen by the increase in Net Position from \$540.4 million to \$1.5 billion, primarily from legal recoveries and the favorable change in the anticipated future cash flows of the Legacy Assets in the NGN Program. In 2016, the TCCUSF maintained sufficient liquidity to meet its obligations as well as to pay off remaining borrowings of \$1.7 billion from the U.S. Treasury. The Fund's Total Assets for 2016 decreased by \$708.6 million primarily as a result of the repayment of \$1.7 billion in U.S. Treasury borrowing partially offset by Net Income from Operations of \$993.0 million. KPMG issued an unmodified audit opinion with no reportable findings.

## **AUDITS IN PROGRESS**

### [Review of NCUA's Supervisory Oversight of Credit Union Cybersecurity Programs](#)

Cybersecurity is the practice of defending computers and servers, mobile devices, electronic systems, networks, and data from cyberattacks. Cyberattacks use malicious code to alter computer code, logic, or data, resulting in disruptive consequences that can compromise data and lead to cybercrimes. NCUA indicates that credit unions rely on applications to ensure accurate, timely, and confidential processing of data. Vulnerabilities, particularly those associated with web-based applications, are increasingly the focus of attacks from external and internal sources for the purpose of committing fraud and identity theft.

NCUA OIG is currently conducting a review of NCUA's Information Systems and Technology (IS&T) Examination Program to determine whether it provides adequate oversight of credit union cybersecurity programs, and to assess whether credit unions are taking sufficient and appropriate measures to protect the confidentiality, availability, and integrity of credit union assets and sensitive credit union information against cyber-attacks. The audit could result in recommendations to NCUA management to improve its IS&T Examination Program going forward.

### [Review of NCUA's Procurement Process](#)

NCUA's procurement authority permits the agency to obtain goods and services required to fulfill its mission. NCUA structured its procurement program to provide a controlled and efficient framework that is fair to competing vendors and beneficial to NCUA. In general, NCUA conducts its procurement activities in compliance with the Federal Acquisition Regulation (FAR), which is a set of rules governing the federal acquisition process. Although NCUA is exempt from complying with the FAR, it uses it for guidance. Various options are available to satisfy procurement needs. However, NCUA's policy is to use the General Services



Administration federal supply schedule, and Government-wide Acquisition Contracts whenever practicable.

NCUA OIG is currently conducting a review of NCUA’s procurement process to determine whether management’s control framework that supports procurement activities is appropriate, complete, and effective and whether NCUA’s procurement activities comply with applicable policies, procedures, laws, and regulations. The audit could result in recommendations to NCUA management to improve its procurement process going forward.

### Review of NCUA’s Comprehensive Records Management

The Federal Records Act defines a record as including all recorded information, regardless of form or characteristics, made or received by a Federal agency under Federal law or in connection with the transaction of public business and preserved, or appropriate for preservation, as evidence of the organization, functions, policies, decisions, procedures, operations, or other activities. Electronic messages include electronic mail and other electronic messaging systems individuals use to communicate. Electronic messages created or received during agency business are Federal records and must be captured and managed in compliance with Federal laws, regulations, and policies.

Each federal agency is required to make and preserve records as well as establish and maintain an active, continuing program to economically and efficiently manage the agency’s records. The program should include effective controls over the creation, maintenance, and use of agency records, and cooperation with the National Archives and Records Administration to improve records management and security. For electronic message records, federal agencies must provide guidance on the proper management of federal records and issue instructions to staff on identifying, managing, retaining, and disposing of email messages determined to be federal records. Finally, agencies are required to protect federal records from unlawful or accidental removal, defacing, alteration, or destruction.

NCUA OIG is currently conducting a review of NCUA’s comprehensive records management process to determine whether NCUA has a comprehensive records management framework, retention, and disposal system in place and whether NCUA is in compliance with applicable records management policies, procedures, laws, and regulations. The audit could result in recommendations to NCUA management to improve its records management process going forward.

### Material Loss Reviews

The Federal Credit Union Act requires NCUA OIG to conduct a Material Loss Review (MLR) of an insured credit union if the loss to the National Credit Union Share Insurance Fund (Share Insurance Fund) exceeds \$25 million or an amount equal to 10 percent of the total assets of the



credit union at the time in which the NCUA Board initiated assistance under Section 208 or was appointed liquidating agent.

During this reporting period, although NCUA did not have a loss to the Share Insurance Fund greater than the \$25 million threshold, the OIG contracted with Moss Adams LLP to conduct an MLR of six federally insured credit unions<sup>1</sup> located in Bensalem and Chester, Pennsylvania. All six credit unions outsourced the management, recordkeeping, data processing, and maintenance of financial records to a third party provider, which allegedly caused each institution to fail due to misrepresentation by management of approximately \$3.2 million in combined credit union assets, primarily through the misstatement of certificates of deposit held as investments.

We conducted this MLR to: (1) determine the cause(s) of the credit unions’ failure and the resulting estimated \$3.2 million loss to the Share Insurance Fund; (2) assess NCUA’s supervision of the credit unions; and (3) provide appropriate recommendations and suggestions to prevent future losses.

The Dodd-Frank Act further requires the OIG to assess all losses to the Share Insurance Fund under the \$25 million threshold to determine whether unusual circumstances exist to warrant conducting a full-scope MLR. During the reporting period, in addition to the loss noted above, the Share Insurance Fund sustained other losses which also fell under the \$25 million threshold. Accordingly, we conducted limited scope reviews of four credit unions to determine whether unusual circumstances existed. Based on our findings, we determined not to conduct a full scope MLR for these four credit unions. We discuss these cases in detail on page 26.

**Significant Recommendations on Which Corrective Action Has Not Been Completed**

Following is a list of OIG reports with significant unimplemented recommendations as of March 31, 2017. NCUA management has agreed to implement corrective action, but has yet to complete those actions. This information was supplied by the NCUA Office of the Executive Director and is monitored within the OIG’s report recommendation tracking system.

Report Number, Title, and Date

OIG-13-09 Material Loss Review of El Paso FCU, August 26, 2013

OIG-15-11 Review of NCUA’s Interest Rate Risk Program, November 13, 2015

OIG-15-09 Audit of NCUA's Measures to Protect Electronic Credit Union Member Information During the Examination Process, June 8, 2015

<sup>1</sup> The six failed credit unions are Chester Upland School Employees Federal Credit Union, O P S EMP Federal Credit Union, Electrical Inspectors Federal Credit Union, Triangle Interests % Service Center Federal Credit Union, Cardozo Lodge Federal Credit Union, and Servco Federal Credit Union.

### Significant Recommendations Open and Brief Summary

1. OIG-13-09, recommendation #1. Implement a more comprehensive strategy for identifying and responding to fraud risk triggers. Areas to address include: 1) Implementing training programs to educate examiners on identifying fraud risk factors and understanding controls to prevent and detect fraud; 2) Developing specific examination procedures to identify fraud risk factors. At a minimum, examiners should identify procedures when a lack of segregation of duties exists and conduct interviews with staff, management, and representatives of the Board of Directors and Supervisory Committee; and 3) Building resources to respond to fraud risk factors efficiently. We agree with suggestions provided by Region IV management to include developing fraud teams at the national or regional level, identifying a list of vendors approved to perform such procedures on an as-needed basis, and requiring credit unions to have forensic procedures performed when deemed appropriate, or an appropriate combination of these responses.

Status: Open. In 2014, NCUA hired a Fraud Risk Specialist. The fraud specialist completed a comprehensive assessment of the fraud program at NCUA and made recommendations. In response, E&I developed and issued Supervisory Letter 15-01 and a Fraud Indicators Workbook. E&I formed a Fraud Working Group made up of fraud experts to develop fraud-related policies and procedures. The fraud specialist continues to develop resources for examiners such as fraud discovery training and a proactive financial modeling tool using call report data to identify fraud. In addition, in January 2015, NCUA released revised Small Credit Union Examination Procedures, which included certain required fraud detection steps and additional expanded review procedures to complete under certain conditions or when concerns are discovered.

In April 2016, NCUA sponsored training to examiners provided by the FBI and a Bank Secrecy Act Program Officer to better identify fraud triggers. Additionally, NCUA incorporated fraud topics into its Problem Resolution training for examiners and provided training to several regions on using Suspicious Activity Reports and LexisNexis to identify fraud triggers. NCUA also incorporated fraud procedures into its Small Credit Union Examination Program and exam procedures through amendments to policy and Supervisory Letters. Management also continues to build its resources through training additional staff on using LexisNexis, fostering relationships with law enforcement, and sharing information as it becomes available. For completion in 2017, NCUA is drafting an Anti-Fraud Strategy Handbook, which outlines the agency's comprehensive strategy related to incorporating fraud into the examination process, as well as drafting a quarterly Off-Site Monitoring Instruction and guidance to be issued to field staff on what actions need to be taken once a fraud is discovered.

2. OIG-15-11, recommendation #1. Modify NCUA's CAMEL Rating System by developing an "S" rating to better capture a credit union's sensitivity to market risk and to improve interest rate risk clarity and transparency.

Status: Open. NCUA has committed to approaching the Board under a new process with a memo to the Executive Director regarding changes to the CAMEL to include the "S." If the Board approves

the change, it will target final implementation by the end of 2018. Management noted that while progress has been made in assessing changes required in NCUA's systems, procedures, and examination guidance to add an "S" component, the change process will be complex. Management explained it involves regulatory changes followed by reprogramming multiple IT systems, data storage and retrieval, and revising examination policies and procedures. NCUA is near finalization on several initiatives to better capture a credit union's sensitivity to market risk and to improve interest rate risk clarity and transparency. Only minor details remain outstanding for the new streamlined IRR review procedures and examiner guidance, as well as the integration of these enhancements into AIREs. This is scheduled for completion in 2017.

3. OIG-15-09, recommendation #3. Enhance NCUA annual security awareness training or provide additional supplementary periodic training that reinforces credit union data protection requirements established in NCUA Instruction 13500.09 and provides NCUA staff with "practical guidance" for addressing "issues within the context of their job responsibilities" as they handle sensitive, confidential, and personally identifiable electronic credit union member information throughout the examination process.

Status: Open. Management indicated that the Office of the Chief Information Officer will update the annual security training to incorporate all recommended enhancements. The training update does not, however, reinforce credit union data protection requirements established in NCUA Instruction 13500.09 or provide NCUA staff with "practical guidance" for addressing issues within the context of their job responsibilities as they handle sensitive, confidential, and personally identifiable electronic credit union member information throughout the examination process. In addition, NCUA has not provided evidence of any alternative "supplementary periodic training" that could facilitate achieving that objective.

### **Summary of Audit Reports Over Six Months Old with Unimplemented Recommendations**

Following are summaries of seven OIG audit reports having 17 unimplemented recommendations, including any associated cost savings as of March 31, 2017. For each of these reports, NCUA management has agreed to implement corrective action, but has yet to complete those actions. The OIG monitors this information within its report recommendation tracking system.

#### Brief Report Summary and Unimplemented Recommendations

1. OIG-13-09 – Material Loss Review of El Paso Federal Credit Union, August 26, 2013, Number of Unimplemented Recommendations: 2, Potential Cost Savings: \$0

We determined that El Paso's Federal Credit Union failed due to management's misappropriation of assets, specifically \$20 million in unrecorded nonmember share certificates, which was over four times the value of the credit union's total assets. Our review identified issues such as management integrity, operational irregularities, internal control, and record keeping deficiencies. In addition, weak Board oversight and governance issues created an environment in which the omission of share

certificates from the books of the credit union could go undetected. We also determined the loss to NCUA’s Share Insurance Fund could have been mitigated had examiners identified several warning signs that we believe should have triggered further examination procedures designed to identify suspicious activity.

Unimplemented Recommendations

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

- a. Implementing training programs to educate examiners on identifying fraud risk factors and understanding controls to prevent and detect fraud.
- b. Developing specific examination procedures to identify fraud risk factors. At a minimum, examiners should identify procedures when a lack of segregation of duties exists and conduct interviews with staff, management, and representatives of the Board of Directors and Supervisory Committee.
- c. Building resources to respond to fraud risk factors efficiently. We agree with suggestions provided by Region IV management, to include developing fraud teams at the national or regional level, identifying a list of vendors approved to perform such procedures on an as-needed basis, requiring credit unions themselves to have forensic procedures performed when deemed appropriate, or an appropriate combination of these responses.

Recommendation #3 – Current procedures allow examiners to rely on bank statements provided by Credit Union personnel as primary evidence for account balances. Given the importance of this information and its susceptibility to fraud, particularly in cases where internal controls are weak, certain account balances should be independently verified. Therefore, we recommend NCUA management update policies and procedures to require third party confirmations be obtained regularly for all accounts where the balance or activity is significant to the operations of the credit union. In addition, NCUA management should require this as part of agreed-upon-procedures conducted by external CPA firms.

- 2. OIG-13-13 – Material Loss Review of G.I.C. Federal Credit Union, December 2, 2013, Number of Unimplemented Recommendations: 1, Potential Cost Savings: \$0

We determined that G.I.C failed due to management’s misrepresentation of \$8.1 million in credit union assets, primarily through the misstatement of certificates of deposit held as investments and cash held on deposit, due to an alleged fraud. We also determined NCUA could have mitigated the loss to its Share Insurance Fund had examiners been more aggressive in requiring the completion of the Supervisory Committee audits, confirmed account balances directly with institutions, and addressed risks related to the failures of the Supervisory Committee and Board of Directors.

### Unimplemented Recommendation

Recommendation #3 – Consider requiring examiners to obtain audit reports directly from independent auditors rather than receiving them from credit union management to avoid potential manipulation. NCUA could accomplish this through an e-file system for independent auditors to upload completed audits. Examples of similar systems include the Federal Audit Clearing House maintained by the U.S. Census Bureau and the Integrated Station Information System (ISIS) used by the Corporation for Public Broadcasting.

3. OIG-14-06 - Material Loss Review of Taupa Lithuanian Credit Union, March 26, 2014, Number of Unimplemented Recommendations: 1, Potential Cost Savings: \$0

We determined Taupa Lithuanian Credit Union (Taupa) failed due to its management fraudulently overstating assets, specifically cash on deposit, and understating shares. We also determined NCUA could have mitigated the loss to its Share Insurance Fund had examiners adequately identified the transaction risks and addressed the red flags that were present at Taupa by performing additional procedures related to those risks.

### Unimplemented Recommendation

Recommendation #1 – Implement a more comprehensive strategy for responding to red flags, including examiner fraud training programs, specific procedures to address fraud risks, and building fraud specific resources and tools.

4. OIG-15-09 - Measures to Protect Electronic Credit Union Member Information During the Examination Process, June 8, 2015, Number of Unimplemented Recommendations: 3, Potential Cost Savings: \$0

We determined that NCUA provides examiners with appropriate tools with which to securely receive electronic information from credit unions during the examination process. However, we also determined: 1) NCUA does not require credit unions to provide sensitive, confidential, and personally identifiable credit union member information to NCUA staff in a protected manner; 2) NCUA needs to improve its policies, procedures and training to help ensure NCUA staff take appropriate measures to protect sensitive, confidential, and personally identifiable electronic credit union member information during examinations; and 3) NCUA needs to improve its guidance to require NCUA staff to use specific tools to transfer sensitive, confidential, and personally identifiable electronic credit union member information during examinations.

### Unimplemented Recommendations

Recommendation #3 – Enhance NCUA annual security awareness training or provide additional supplementary periodic training that reinforces credit union data protection requirements established in NCUA Instruction 13500.09 and provides NCUA staff with “practical guidance” for addressing “issues within the context of their job responsibilities” as they handle sensitive, confidential, and



personally identifiable electronic credit union member information throughout the examination process.

Recommendation #5 – Continue to pursue and implement the secure file transfer solution NCUA is assessing to transfer sensitive, confidential, or personally identifiable electronic credit union member information.

Recommendation #7 – Enhance NCUA annual security awareness training to reinforce to NCUA staff the availability, use, and applicability of secure NCUA tools to transfer sensitive, confidential, or personally identifiable electronic credit union member information.

5. OIG-15-10 – FY 2015 Independent Evaluation of The Effectiveness of NCUA’s Information Security Program Under The Federal Information Security Modernization Act of 2014, November 13, 2015, Number of Unimplemented Recommendations: 4, Potential Cost Savings: \$0

During the 2015 FISMA audit, we evaluated NCUA’s information security program and practices, its privacy management program, and conducted a vulnerability assessment of NCUA’s information systems components. In resolving prior year issues and recommendations, we determined NCUA continued to strengthen its information security program during 2015. NCUA also made progress in documenting its privacy program and did not have any repeat findings from prior years. We also determined NCUA needs to make improvements in its risk management and configuration management programs and with its authentication controls.

#### Unimplemented Recommendations

Recommendation #1 – NCUA complete the process of assessing, documenting, and communicating the organization-wide risk tolerance in accordance with NIST SP 800-37, Revision 1 Guide for Applying the Risk Management Framework to Federal Information Systems.

Recommendation #2 – OCIO re-align its current information system risk tolerance with the organization-wide risk tolerance.

Recommendation #4 – OCIO complete the migration of its unsupported applications from their existing platform to platforms that are vendor-supported.

Recommendation #6 – OCIO update the General Support System Security Plan to include the control implementation descriptions for NIST privacy controls once NCUA documents and disseminates the organization-wide privacy policies and procedures and associated controls.



6. OIG-15-11 - Review of NCUA’s Interest Rate Risk Program, November 13, 2015, Number of Unimplemented Recommendations: 2, Potential Cost Savings: \$0

We determined that NCUA may not have been effectively capturing Interest Rate Risk (IRR) when assigning a composite CAMEL rating to a credit union. NCUA currently assesses sensitivity to market risk under the "L" in its CAMEL rating. However, we determined that combining sensitivity to market risk with liquidity may understate or obscure instances of high IRR exposure in a credit union. The addition of an “S” rating to its CAMEL Rating System to capture and separately assess a credit union’s sensitivity to market risk should improve NCUA’s ability to accurately measure and monitor interest rate risk.

Unimplemented Recommendations

Recommendation #1 – Modify NCUA’s CAMEL Rating System by developing an “S” rating to better capture a credit union’s sensitivity to market risk and to improve interest rate risk clarity and transparency.

Recommendation #2 – Revise the current “L” in NCUA’s CAMEL Rating System to reflect only liquidity factors.

7. OIG-16-01 – Audit of the National Credit Union Administration’s Restitution Orders Process at the Asset Management and Assistance Center, February 9, 2016, Number of Unimplemented Recommendations: 4, Potential Cost Savings: \$0

We determined that NCUA’s Asset Management and Assistance Center (AMAC) adequately documents restitution orders and receipt of restitution payment. However, we also determined there are areas where AMAC management could improve the restitution orders process by following up and assisting the Department of Justice (DOJ) to potentially improve collections and confirm accuracy when accounting for restitution orders owed to liquidation estates. Specifically, we determined AMAC management 1) did not assist the DOJ through systematic follow-up regarding the status of offenders and receipt of payments, 2) did not have write down policies and procedures for expired and uncollectible restitution orders, and 3) had no policies and or procedures over the restitution process at the onset of our review. In addition, we determined the internal control environment over AMAC’s restitution orders process needed improvement.

Unimplemented Recommendations

Recommendation #1 – Establish a line of communication and, if necessary, enter into an MOU with both DOJ’s Financial Litigation Unit and the Treasury Offset Program to maximize restitution recovery opportunities.



Recommendation #2 – Conduct periodic follow-ups with DOJ and the Treasury Offset Program regarding the status of offenders extending through end of the statute of the restitution orders currently on file.

Recommendation #7 – Once the new processes are developed based on Recommendations 1 through 7, revise NCUA Instruction No. AMAC 3900.01 to reflect any function, procedures, or processes conducted by any AMAC official related to internal and external monitoring and follow-up of restitution orders.

Recommendation #8 – Develop Desktop Procedures for all AMAC Divisions involved in the restitution orders process. The procedures should capture the flow of the entire restitution order process from initial receipt of the order to the closing of the loan account.

### Recommendations for Corrective Action Made During the Reporting Period

1. OIG-16-08 – FY2016 Federal Information Security Modernization Act Compliance, November 10, 2016, Number of Recommendations: 23, Potential Cost Savings: \$0

NCUA OIG identified the following seven information security program areas where NCUA needs to make improvements: configuration management; incident response; contingency planning programs; account management, plan of action and milestones; oversight of contractor systems; and documenting program controls in its system security plan.

Because of concerns over publicly revealing information that could compromise the security of the agency’s information technology infrastructure, there are 15 recommendations in this report that we did not make public. In addition, there are eight recommendations that were made public as follows:

Recommendation #5 – Update the NCUA Identity and Access Management Procedures policy to address the consequence of new hires not completing the Rules of Behavior within the required ten-day window of entry on duty and enforce the specified consequence.

Recommendation #10 – OCIO will implement a process to ensure NCUA maintains a complete inventory of all approved software by June 30, 2017.

Recommendation #15 – NCUA finalize its organizational-wide risk tolerance by incorporating the degree of risk of uncertainty and communicate the risk tolerance organization-wide.

Recommendation #16 – OCIO re-align its current information system risk tolerance with the organization-wide risk tolerance.

Recommendation #17 – Coordinate developing, documenting and implementing a process to ensure program offices notify OCIO of contractor systems early in the procurement process to allow completion of a risk assessment before the system is permitted to operate within NCUA’s information system environment.

Recommendation #18 – OCIO enforce policy to ensure it assesses risk(s) for all contractor systems and documents and formally accepts residual risk(s) to the agency prior to initial use.

Recommendation #19 – Update the OCIO Plan of Action and Milestones (POA&M) Policy and Procedures to address reasonable timelines within which the agency must fully document and update its POA&M items on an ongoing basis.

Recommendation #20 – Enforce NCUA policy to ensure the agency appropriately and timely documents and updates POA&M items to reflect the current status on an ongoing basis, and the agency tests, validates and documents corrective actions in order to close POA&Ms.

2. OIG-17-05 – Material Loss Review Of Chester Upland School Employees, O P S EMP, Electrical Inspectors, Triangle Interests % Service Center, Cardozo Lodge, And Servco Federal Credit Unions, February 23, 2017, Number of Recommendations: 2, Potential Cost Savings: \$0

NCUA OIG determined the Credit Unions failed due to overstatement of approximately \$3.2 million in assets, primarily investments in certificates of deposit, allegedly due to fraud. Specifically, we identified the following factors created an environment in which the overstatement of assets went undetected: 1) questionable management integrity and performance; 2) weak supervisory committee oversight; and 3) weak Board of Directors oversight. We also determined NCUA might have identified the alleged fraud sooner and mitigated the loss to the Share Insurance Fund had it followed National Supervision Policy Manual and identified the Supervisory Committee Audits as unacceptable, confirmed account balances directly with institutions, and addressed risks related to the failures of the Supervisory Committees and Boards of Directors.

Recommendation #1 – Revise procedures in the small credit union examination program to require an independent verification of investment balances when the examiner determines the verification performed during the audit was inadequate or was not performed, and risk factors related to investments are material.

Recommendation #2 – Revise examination procedures to include a review of how the supervisory committee evaluated the independence and competency of individuals selected to perform the supervisory committee audit.

## Report on Credit Union Losses under Materiality Level of \$25 Million

Dodd-Frank requires NCUA OIG to perform a limited review where the Share Insurance Fund incurred a loss below the \$25 million threshold with respect to an insured credit union. The OIG must report to the NCUA Board and the Congress every six months on the results of the limited reviews and the timeframe for performing any subsequent in-depth reviews we determine are necessary.

This report on losses below the \$25 million threshold covers the six-month period from October 1, 2016 to March 31, 2017. For all losses to the Share Insurance Fund under the MLR threshold, we determined (1) why NCUA initiated assistance, and (2) whether any unusual circumstances existed that might warrant an in-depth review of the loss.

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

We conducted limited scope reviews of four credit unions that incurred losses to the Share Insurance Fund under \$25 million between October 1, 2016 and March 31, 2017. Based on those limited reviews, we determined that none of the losses warranted conducting additional work because we found no unusual circumstances, or we had already addressed the reasons identified for the losses in recommendations to the agency in previous MLR reports.

The chart below provides details on the four credit union losses to the Share Insurance Fund below the \$25 million threshold. It provides details on the credit union, such as the date of failure, the estimated loss to the Share Insurance Fund, and grounds for conservatorship, merger, or other factors. The chart also provides our decision whether to terminate or proceed with a full scope MLR of the credit union.



DECISIONS REGARDING LOSSES LESS THAN \$25 MILLION					
OIG Decision**	Credit Union	Region	Date Closed	Est. Loss to Share Insurance Fund	Grounds for Liquidation or Appointment
Terminate	Valley State Credit Union	I	3/31/2017	\$3,188,808	At-cost failure due to alleged management fraud, inadequate internal controls, an underfunded allowance for loan and lease losses account, off balance sheet risk exposures, and a high-risk, under-collateralized auto loan portfolio rendering the credit union insolvent. Purchased and assumed by ELGA Credit Union.
Terminate	First African Baptist Church Federal Credit Union	II	11/29/2016	\$14,000	At-cost failure due to declining net worth, negative earnings and weak internal controls rendering the credit union insolvent. Purchased and assumed by American Heritage Federal Credit Union.
Terminate	Anchor Seven Federal Credit Union	III	11/1/2016	\$70,422	At-cost failure due to negative earnings, lack of management, record keeping and lending deficiencies, high-risk loan portfolio with weak loan documentation. Merged with assistance to Vystar Credit Union.
Terminate	Florida Conference AME Church Federal Credit Union	III	3/17/2017	\$312,000	At-cost failure due to unreconciled accounts, weak internal controls, record keeping deficiencies, insufficient management, and an underfunded allowance for loan and lease losses account. Purchased and assumed by Gulf Winds Federal Credit Union.

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



## Peer Reviews – October 1, 2016 through March 31, 2017

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

### External Peer Review of NCUA OIG, Office of Audit

The Consumer Product Safety Commission (CPSC) OIG completed our most recent peer review on March 30, 2016, for the three-year period ended September 30, 2015. The CPSC OIG issued its report entitled System Review Report and rendered the opinion that the system of quality control for the NCUA OIG, Office of Audit, was suitably designed and complied with, thus providing reasonable assurance the system of controls conformed with applicable professional standards in all material respects. As a result, we received a peer rating of pass. In addition, we have no outstanding recommendations from this external peer review. A copy of this report is included herein as Appendix A.

### External Peer Review of Architect of the Capitol OIG, Office of Audit

The NCUA OIG completed a peer review of the Architect of the Capitol (AOC) OIG. On September 4, 2015, we issued an external peer review report for the audit function of the AOC OIG for the three year period ended March 31, 2015. The AOC received a rating of pass and has no outstanding recommendations related to the peer review report.



**INVESTIGATIVE ACTIVITY**

In accordance with professional standards and guidelines established by the United States Department of Justice, OIG’s Office of Investigations (OI) conducts investigations of criminal, civil, and administrative wrongdoing involving the agency’s programs, operations, and personnel. Our investigative mission is to fight fraud, waste, and abuse while promoting efficiency and economy within NCUA and its programs and operations. In this regard, we investigate referrals and allegations of misconduct on the part of NCUA employees, former employees, and contractors. Investigations may involve possible violations of regulations involving Federal employee responsibilities and conduct, agency policies, Federal criminal law, and other statutes and regulations.

We also routinely receive complaints from credit union officials and their members involving NCUA programs and officials. We examine these complaints and determine if there is any indication of misconduct or wrongdoing by an NCUA employee or contractor. If not, we refer the complaint to NCUA’s Office of Consumer Financial Protection and Access (OCFPA) or appropriate regional office for response, or close the matter if contact with OCFPA or the regional office indicates that the matter has already been appropriately handled.

The table below details OI’s investigative activity and reports issued during the reporting period.

<b>INVESTIGATIVE ACTIVITY/REPORTS ISSUED</b> October 1, 2016 – March 31, 2017	
	<b>Total Number</b>
(A) Investigative reports issued during the reporting period	1
(B) Persons referred to the Department of Justice for criminal prosecution during the reporting period	0
(C) Persons referred to State and local prosecuting authorities for criminal prosecution during the reporting period	0
(D) Indictments and criminal informations during the reporting period that resulted from any prior referral to prosecuting authorities	0

With regard to the information provided in the table above, OI maintains a manual case tracking system. If investigative allegations involve a named suspect, then cases are designated and tracked by subject name. Cases referred to DOJ and/or State and local prosecuting authorities for criminal prosecution are also designated, referred, and tracked by subject name, if known. In





cases where the subject is unknown, OI uses a subject matter title to designate, track, and, as appropriate, refer cases.

## INVESTIGATIONS

During the reporting period, OI did not conduct any investigations involving a senior NCUA employee. OI did issue one investigative report on a non-senior level NCUA employee, as described below:

### Official Misconduct (Unprofessional Conduct)

During the reporting period, we obtained information that an employee behaved in an abusive and disrespectful manner toward hotel management and employees while on official business. The investigation substantiated the unprofessional conduct. OI issued a final Report of Investigation and referred the matter to agency management for official action. The case remains open pending notice of agency action, if any.

### Whistleblower Retaliation

We did not handle directly any instances of whistleblower retaliation during the reporting period.

### Attempts to Interfere with IG Independence

There were no attempts on the part of management to interfere with IG independence including restricting communications between OIG and Congress or using budgetary constraints designed to limit the capabilities of OIG.

Moreover, there have been no incidents where NCUA resisted or objected to OIG oversight activities. There have also been no restrictions or delays in our access to to agency information.

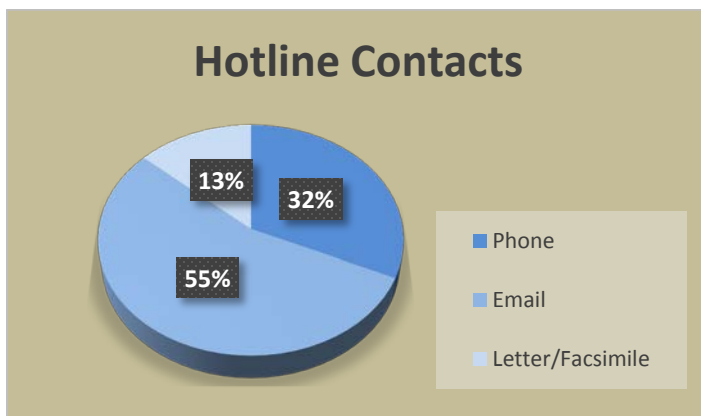
## OIG HOTLINE CONTACTS

The OIG maintains a 24-hour toll free hotline to enable employees and citizens to call in and provide information about suspected fraud, waste, and abuse, or mismanagement involving agency programs or operations. Additionally, OIG receives complaints from an off-site post office box, electronic mail, and facsimile messages. OI has also developed an electronic version of a hotline complaint form, located on the NCUA intranet. The electronic form offers an additional venue for confidential employee and contractor communication with OIG. All information received from any of these sources is referred to as a hotline contact. Our Office Manager, under the direction of the Director of Investigations, administers the OIG hotline program.

In recent years, the OIG Hotline has also become a valuable repository for reports of potential cases of fraud in credit unions. While OIG does not, in most cases, have jurisdiction to

investigate fraudulent activity that takes place in credit unions, it analyzes the information obtained through the Hotline and refers potential cases of fraud to the appropriate NCUA regional office, the NCUA Office of Examination & Insurance, and/or the NCUA Office of General Counsel for immediate review and action.

During this six-month period, we processed approximately 104 hotline contacts, the majority of which were from consumers seeking assistance with problems encountered within their respective credit unions. As discussed above, these contacts were generally referred to OCFPA and regional offices for action. A relatively small number of these contacts required additional action by OI to determine whether the matter warranted investigation.



Phone	33
Email	70
Letter/Facsimile	14
<b>Total:</b>	<b>104</b>



**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 NCUA and to make recommendations concerning their impact. Moreover, we routinely review agency program and 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, OIG reviewed 27 items, including proposed legislation, final and proposed regulations, NCUA Letters to Credit Unions, and NCUA Regulatory Alerts (RA). OIG also responded to five Freedom of Information Act (FOIA) requests and two Touhy requests.

<b>SUMMARY OF STATUTES AND REGULATIONS REVIEWED</b>	
<b>Legislation</b>	<b>Title</b>
S. 576	Follow the Rules Act
S. 585	Dr. Chris Kirkpatrick Whistleblower Protection Act
H.R. 1244	Capital Access for Small Businesses and Jobs Act
H.R. 599	Merit Act
H.R. 69	Thoroughly Investigating Retaliation Against Whistleblowers Act
H.R. 5983	Financial CHOICE Act
H.R. 5	Regulatory Accountability Act
H.R. 26	Regulations from the Executive in Need of Scrutiny Act
S. 795	Enhanced Whistleblower Protections for Contractor and Grantee Employees
H.R. 5920	Whistleblower Protections for Contractors Act
H.R. 5143	Transparent Insurance Standards Act
H.R. 6392	Systemic Risk Designation Improvement Act
H.R. 6066	Cybersecurity Responsibility and Accountability Act
<b>Regulations/Rulings</b>	<b>Title</b>



12 CFR Part 747	Final Action: Civil Monetary Penalty Inflation Adjustment
12 CFR Part 792	Final Action: Revisions to the Freedom of Information Act Regulation
12 CFR Part 701, 721	Final Action: Federal Credit Union Occupancy, Planning and Disposal of Acquired and Abandoned Premises, Incidental Powers
12 CFR Parts 701, 702, 703, 709, 741, and 745	ANPR: Alternative Capital
12 CFR Part 705	Final Action: Community Development Revolving Loan Fund
12 CFR Part 760	JNPR: Loans in Areas Having Special Flood Hazards – Private Flood Insurance
12 CFR Part 701	Proposed Rule: Chartering and Field of Membership Manual
<b>Letters to Credit Unions</b>	<b>Title</b>
17-CU-02	Risk-Focused Examinations and Compliance Risk
17-CU-01	Supervisory Priorities for 2017
16-CU-12	Risk-Based Examination Scheduling Policy
16-CU-11	Member Business Loans Guidance Added to Examiner’s Guide
<b>Regulatory Alerts (RA)</b>	<b>Title</b>
17-RA-03	Submission of 2016 Home Mortgage Disclosure Act Data
17-RA-02	Home Mortgage Disclosure Act Data Requirements for Calendar Year 2017
17-RA-01	2016 Mortgage Servicing Rule Fair Debt Collection Practices Act Interpretive Rule



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

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

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



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

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



**TABLE III: SUMMARY OF OIG ACTIVITY**

October 1, 2016 through March 31, 2017

Part I – Audit Reports Issued		
Report Number	Title	Date Issued
OIG-16-08	FY 2016 Review of NCUA’s Compliance with FISMA 2014	11/10/2016
OIG-16-09	Review of NCUA’s Digital Accountability and Transparency Act of 2014 (DATA Act) Readiness	11/16/2016
OIG-16-10	Audit of NCUA’s Closing Package Schedule of Other Assets and Contributed Capital as of Sept. 30, 2016	11/22/2016
OIG-17-01/ 02/03/04	FY 2016 Financial Statement Audits	2/15/2017
OIG-17-05	Material Loss Review of Chester Upland School Employees, O P S EMP, Electrical Inspectors, Triangle Interests % Service Center, Cardozo Lodge, and Servco Federal Credit Unions	2/23/2017
OIG-17-06	FY 2016 Financial Statement Audits (TCCUSF)	2/28/2017
Part II – Audits in Progress ( <i>as of March 31, 2017</i> )		
Review of NCUA’s Supervisory Oversight of Credit Union Cybersecurity Programs		
Review of NCUA’s Procurement Process		
Review of NCUA’s Comprehensive Records Management		



<b>INDEX OF REPORTING REQUIREMENTS OF THE INSPECTOR GENERAL ACT OF 1978, AS AMENDED</b>		
<b>Section</b>	<b>Reporting Requirement</b>	<b>Page</b>
<b>4(a)(2)</b>	Review of legislation and regulations	31
<b>5(a)(1)</b>	Significant problems, abuses, and deficiencies	12
<b>5(a)(2)</b>	Recommendations for corrective action	23
<b>5(a)(3)</b>	Significant recommendations on which corrective action has not been completed	16
<b>5(a)(4)</b>	Matters referred to prosecutive authorities	None
<b>5(a)(5)</b>	Summary of instances where agency refused or failed to provide requested information	None
<b>5(a)(6)</b>	List of audit reports issued during the reporting period	35
<b>5(a)(7)</b>	Summary of significant reports issued during the reporting period	12
<b>5(a)(8)</b>	Statistical table on audit reports with questioned costs	33
<b>5(a)(9)</b>	Statistical table on audit reports with recommendations that funds be put to better use	34
<b>5(a)(10)(A)</b>	Summary of each audit report over six months old for which no management decision has been made	None
<b>5(a)(10)(B)</b>	Summary of each audit report over six months old for which no management comment was returned within 60 days	None
<b>5(a)(10)(C)</b>	Summary of each audit report over six months old for which there are unimplemented recommendations	18
<b>5(a)(11)</b>	Significant revised management decisions	None
<b>5(a)(12)</b>	Significant management decisions with which the OIG disagreed	None





<b>INDEX OF REPORTING REQUIREMENTS (CONT.)</b>		
<b>5(a)(14)(A)(B)</b>	Results of any peer review conducted during the reporting period, or if no peer review was conducted, a statement identifying the date of last peer review.	38
<b>5(a)(15)(16)</b>	Peer reviews conducted by another OIG during the reporting period, and any outstanding recommendations from any current or prior peer review	27
<b>5(a)(17)</b>	Statistical table on investigative reports issued during the reporting period	28
<b>5(a)(18)</b>	Description of metrics used for developing the investigative report statistical table	28
<b>5(a)(19)</b>	Investigations conducted involving a senior Government employee	None
<b>5(a)(20)</b>	Detailed description of any instances of whistleblower retaliation	None
<b>5(a)(21)</b>	Detailed description of any attempt by the Agency to interfere with the independence of the Office	None
<b>5(a)(22)(A)</b>	Detailed description of any inspection, evaluation, and audit that was closed and was not disclosed to the public	None
<b>5(a)(22)(B)</b>	Detailed description of any investigation involving a senior Government employee that was closed and was not disclosed to the public	None

**Appendix A: System Review Report (Peer Review of NCUA OIG)**



**Peer Review of the Audit Operations of  
the National Credit Union Administration  
Office of the Inspector General**

**ISSUED:  
March 30, 2016**



**U. S. CONSUMER PRODUCT SAFETY COMMISSION  
BETHESDA, MD 20814**

Christopher W. Dentel  
Inspector General

Tel: 301.504-7644  
Fax: 301.504-7004  
Email: cdentel@cpsc.gov

**System Review Report**

March 30, 2016

Mr. James Hagen, Inspector General  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314

Dear Mr. Hagen:

We have reviewed the system of quality control for the audit organization of the National Credit Union Administration (NCUA), Office of Inspector General (OIG) in effect for the year ended September 30, 2015. A system of quality control encompasses NCUA OIG's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of conforming with *Government Auditing Standards*.<sup>1</sup> The elements of quality control are described in *Government Auditing Standards*. The NCUA OIG is responsible for establishing and maintaining a system of quality control that is designed to provide NCUA OIG with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and NCUA OIG's compliance therewith based on our review.

Our review was conducted in accordance with *Government Auditing Standards* and the Council of the Inspectors General on Integrity and Efficiency (CIGIE) *Guide for Conducting Peer Reviews of the Audit Organizations of Federal Offices of Inspector General*.<sup>2</sup> During our review, we interviewed NCUA OIG personnel and obtained an understanding of the nature of the NCUA OIG audit organization, and the design of NCUA OIG's system of quality control sufficient to assess the risks implicit in its audit function. Based on our assessments, we selected audits and attestation engagements, collectively referred to as "audits," and administrative files to test for conformity with professional standards and compliance with NCUA OIG's system of quality control. The

<sup>1</sup> United States Governmental Accountability Office, *Government Auditing Standards*, dated December 2011

<sup>2</sup> CIGIE *Guide for Conducting Peer Reviews of the Audit Organizations of Federal Offices of Inspector General*, dated September 2014



audits selected represented a reasonable cross-section of the NCUA OIG audit organization, with emphasis on higher-risk audits. Prior to concluding the peer review, we reassessed the adequacy of the scope of the peer review procedures and met with the NCUA OIG management to discuss the results of our review. We believe that the procedures we performed provide a reasonable basis for our opinion.

In performing our review, we obtained an understanding of the system of quality control for the NCUA OIG audit organization. In addition, we tested compliance with the NCUA OIG’s quality control policies and procedures to the extent we considered appropriate. These tests covered the application of the NCUA OIG’s policies and procedures on selected audits. Our review was based on selected tests; therefore, it would not necessarily detect all weaknesses in the system of quality control or all instances of noncompliance with it.

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

The enclosure to this report identifies the NCUA OIG offices that we visited and the audits that we reviewed.

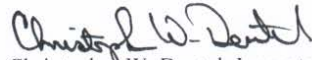
In our opinion, the system of quality control for the audit organization of the NCUA OIG in effect for the year ended September 30, 2015, has been suitably designed and complied with to provide the NCUA OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Audit organizations can receive a rating of *pass*, *pass with deficiencies*, or *fail*. The NCUA OIG has received an External Peer Review rating of *pass*.

As is customary, we have issued a letter dated March 30, 2016 that sets forth findings that were not considered to be of sufficient significance to affect our opinion expressed in this report.

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



We made certain comments related to NCUA OIG's monitoring of audits performed by IPAs that are included in the above referenced letter dated March 30, 2016.

  
Christopher W. Dentel, Inspector General

Enclosure



**ENCLOSURE**

**Scope and Methodology**

We tested compliance with NCUA OIG audit organization’s system of quality control to the extent we considered appropriate. These tests included a review of 2 of 10 audit reports issued during the period October 1, 2014, through September 30, 2015. We also reviewed the internal quality control reviews performed by NCUA OIG.

In addition, we reviewed NCUA OIG’s monitoring of audits performed by IPAs where the IPA served as the auditor during the period October 1, 2014, through September 30, 2015. During the period, NCUA OIG contracted for the audit of its agency’s fiscal year 2014 financial statements. The NCUA OIG also contracted for certain other audits that were to be performed in accordance with *Government Auditing Standards*.

We visited NCUA’s offices located Alexandria, VA.

<b>Reviewed Engagements Performed by NCUA OIG</b>		
<u>Report No.</u>	<u>Report Date</u>	<u>Report Title</u>
14-09	11/26/2014	Review of NCUA’s Efforts to Promote Opportunity and Achieve Diversity in Senior Management
15-09	6/8/2015	NCUA Measures to Protect Credit Union Member Information during the examination process
<b>Reviewed Monitoring Files of NCUA OIG for Contracted Engagements</b>		
<u>Report No.</u>	<u>Report Date</u>	<u>Report Title</u>
14-08	11/13/2014	Independent Evaluation of NCUA’s Compliance with the Federal Information Security Management Act (FISMA) 2014
15-02/03/04/05	2/17/2015	FY2014 Financial Statement Audits for Central Liquidity Facility, Community Development Revolving Loan Fund, Operating Fund and share Insurance fund



National Credit Union Administration

**Office of Inspector General**

March 22, 2016

Christopher W. Dentel  
Inspector General  
U.S. Consumer Product Safety Commission  
Bethesda, Maryland 20814

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

Dear Mr. Dentel:

We appreciate the work conducted by your staff in reviewing the quality control process for the audit function at the National Credit Union Administration Office of Inspector General. We agree with your opinion that the system of quality control for the audit function has been suitably designed and complied with to provide reasonable assurance of performing and reporting in conformity with professional standards in all material aspects. We have no additional comments on the final System Review draft report provided. Thank you for your efforts in completing this review.

Sincerely,

A handwritten signature in black ink, appearing to read "James W. Hagen".

James W. Hagen  
Inspector General

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1775 Duke Street – Alexandria, VA 22314-6113 – 703-518-6300