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From Plans to Findings
Audit Oversight Essentials for Committees
Audit/Supervisory Committees

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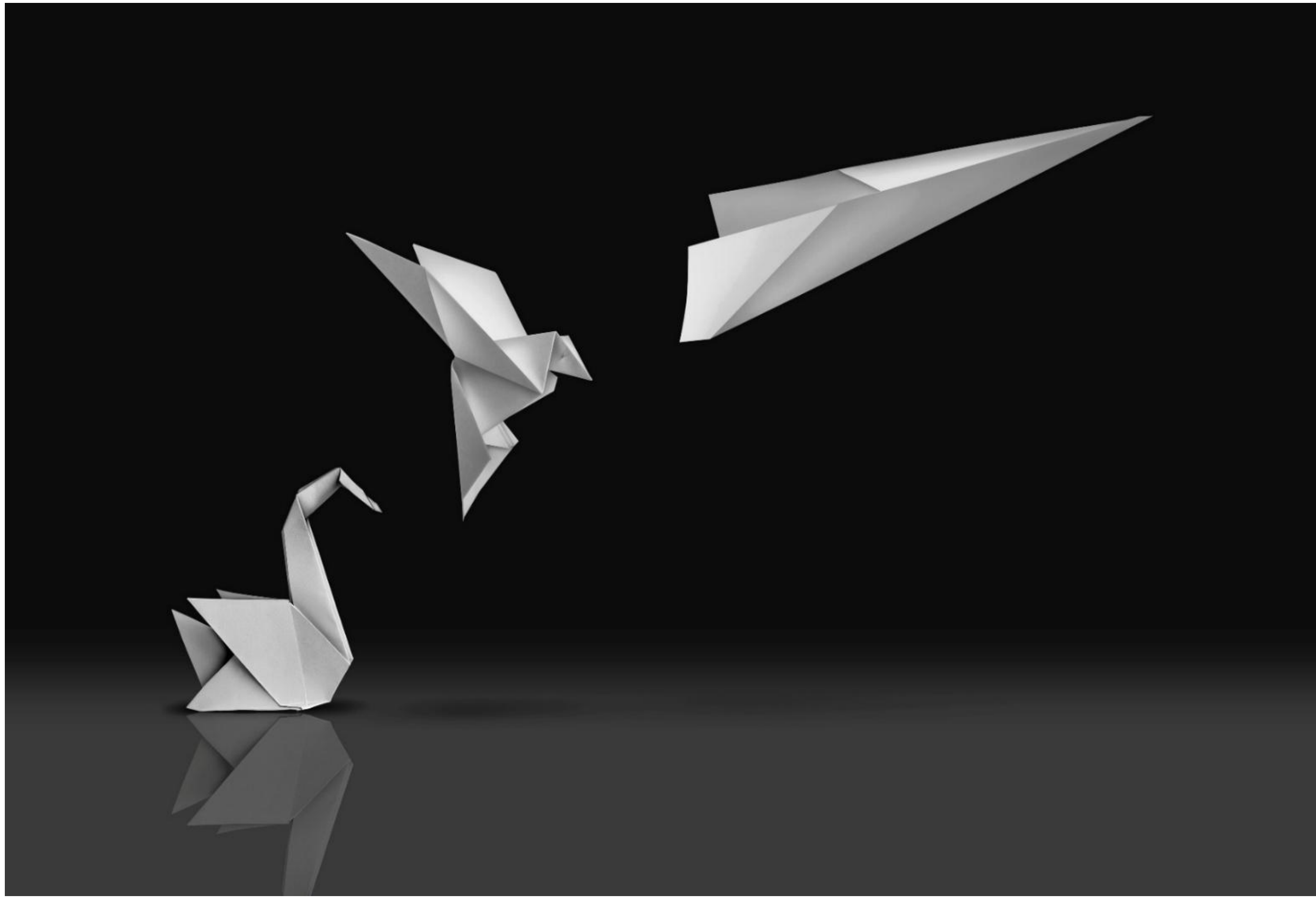
Agenda

- Governance Framework
- Roles & Responsibilities
- Financial Reporting Oversight
- Internal Controls Oversight
- Case Studies
- Risk Oversight
- Best Practices
- Questions



Supervisory Committee Structure

- 3 - 5 volunteer members
- Supervisory Committee elected either by Board of Directors (FCU) or by membership
- Can have up to one Board member (FCU)
- Independent from staff and Board of Directors

Prerequisite Skills

- Make a commitment to serve by taking an active role and having an enthusiastic attitude
- Have the ability to work as a team member
- Be a credit union member in good standing
- Be bondable
- Understand or have the ability to learn financial statements and the laws governing credit unions

Governance Framework – Board of Directors

Clear reporting and accountability structure saves time and reduces the possibility of failure.

- Board provides overall oversight of the credit union.
  - The board decides on risk tolerance.
  - The board communicates and documents the risk tolerance through policies and policy limits.
- Management gets its authorization through the board.

- Management is responsible for day-to-day execution of initiatives that have been assigned to them by the board.
  - They can’t act without board authority.
  - They have to follow policies. The policies tell them what products they can offer, and what the limits are that govern the products.
  - The Management drafts procedures in contemplation of the policies to document how they want the credit union employees to execute the policies.

- The Supervisory Committee operates independently of the board and management. They are responsible for monitoring that the policies and procedures are sound and that they are followed.
- They make sure that management and employees follow the stated tolerance limits to safeguard member assets.

Governance Framework – Reporting Structure

NCUA Mandates

The Supervisory Committee must ensure:

- That the credit union adheres to the measurement and filing requirements for the NCUA. (filing the quarterly 5300 call report)
- Complete the Annual Financial Statement Audits.
- Verify or cause to verify the member accounts.
- Act to avoid the imposition of sanctions for failure to comply with these requirements.

<u>Guidelines to Avoid Sanctions:</u>

- Ensure there is a system of internal controls
- Ensure there is an audit process in place
- Ensure there is a process for monitoring compliance with laws and regulations
- Inspect, or cause to inspect various balance sheet accounts that the supervisory committee believes are necessary

Call Special Meeting of the Members

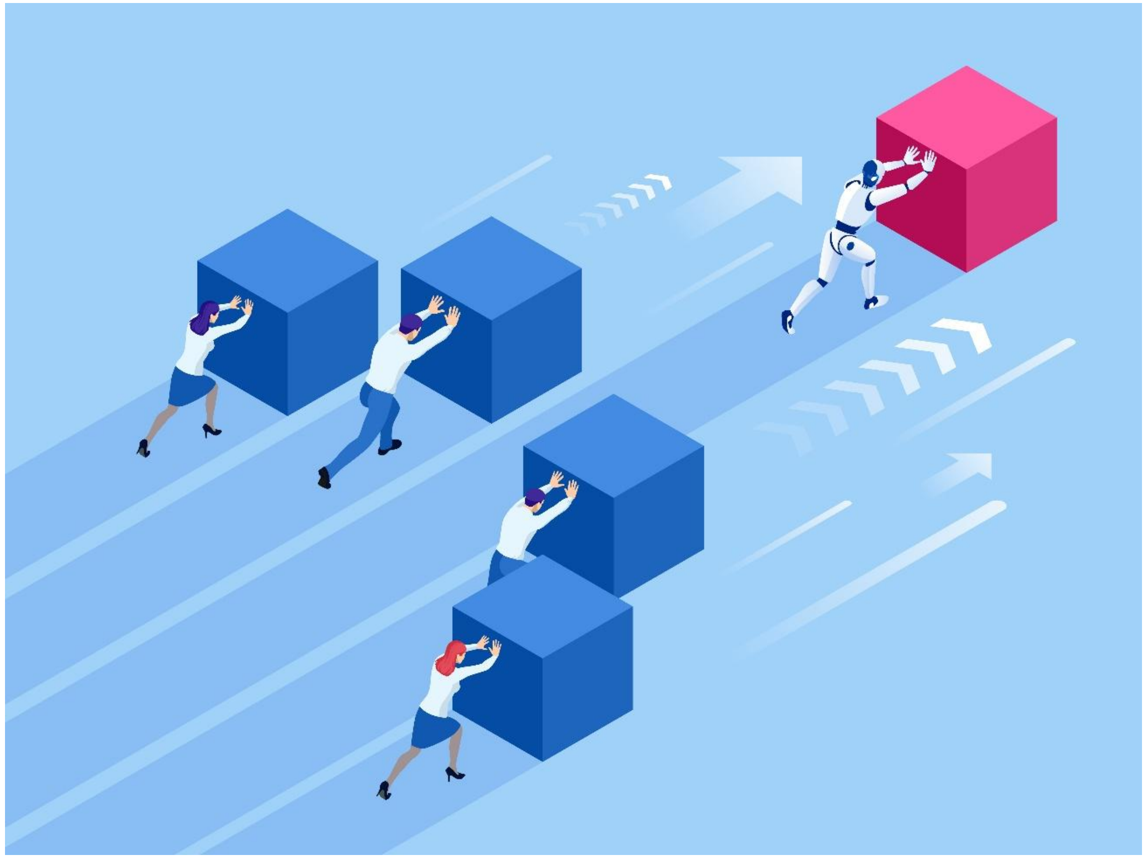
Under Federal Credit Union (FCU) Bylaws and the FCUA, if a supervisory committee places a board member on suspension, they must hold a special meeting of the members **not less than 7 days and no more than 14 days** after the suspension.

- Depending on your specific charter or state, these procedures may vary slightly:
  - **Federal Credit Unions**: The supervisory committee must call and hold a special meeting of the members within 7 to 14 days to vote on the suspension.
  - **State-Chartered Credit Unions**: Some states (such as Washington) give up to 90 days, while others (such as Utah) require a special meeting to be called within 30 days of the suspension.

These are usually related to issues such as self-dealing fraud at the board and management level.

External Audit Oversight

- Appoint & compensate auditors
- Review audit scope
- Discuss findings with the auditors



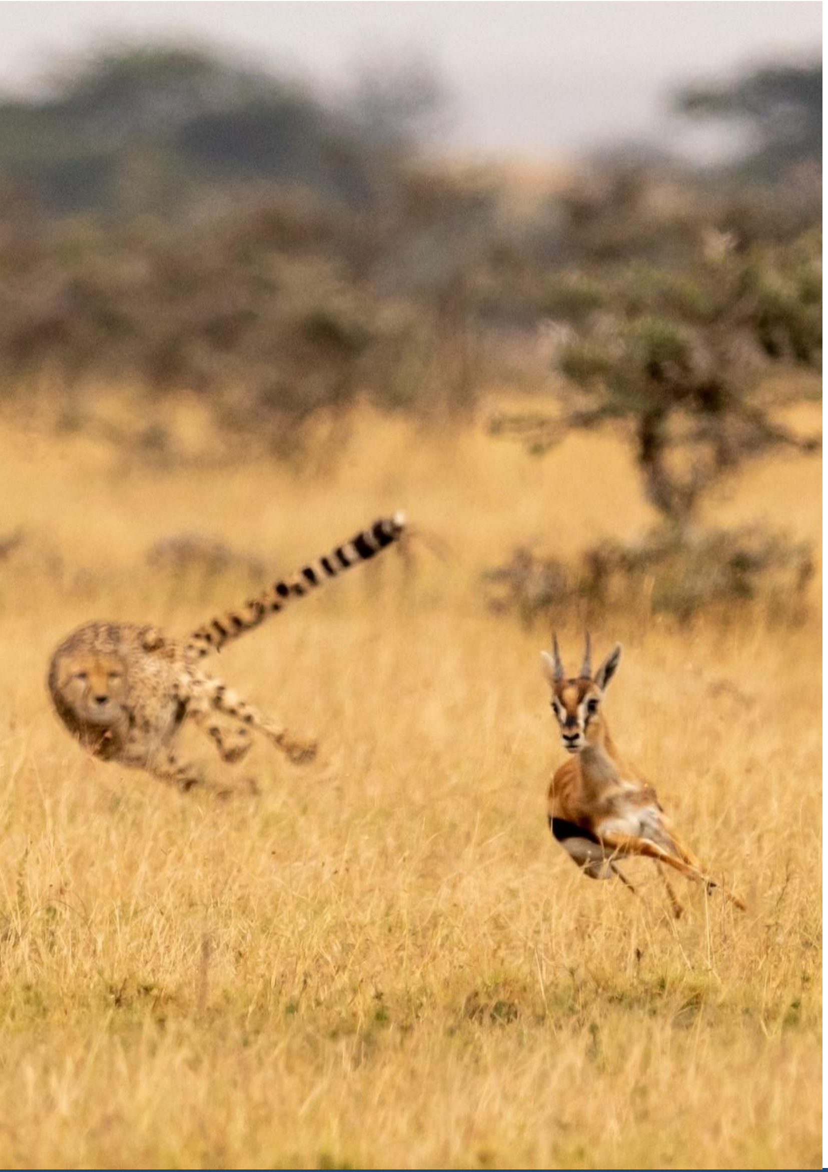
Financial Reporting Oversight

At the Supervisory Committee meetings, management will review Financial Reports:

- Periodic Financial Statements
- Budget Variance Reports
- Delinquency & Charge-Offs
- Suspicious activity reports (SARs)
- Follow-up on audit findings

- Review key performance indicators (KPIs)
- Assess accounting policies

Internal Controls Oversight



- Understand control framework
- Monitor deficiencies
- Ensure remediation
- Identify key risks including cybersecurity
- Align with enterprise risk management
- Promote strong control culture

What Is an MLR, Why Is It Ordered, and When Does It Happen?

⚖ LEGAL AUTHORITY

Statute: Section 216(j) of the Federal Credit Union Act
12 U.S.C. §1790d(j)

Mandate: The OIG is REQUIRED to conduct an MLR when the NCUSIF incurs a material loss — or when unusual circumstances warrant an in-depth review.

Definition of Material Loss: A loss exceeding $25 million* AND an amount equal to 10% of the credit union's total assets at the time NCUA initiated assistance or was appointed liquidating agent.

Note: *Threshold raised from $10M to $25M by the Wall Street Reform and Consumer Protection Act signed July 21, 2010.

🔍 WHAT THE OIG EXAMINES

01 Determine the CAUSE(S) of the credit union's failure and the resulting loss to the NCUSIF.

02 Assess NCUA and State Supervisory Authority (SSA) supervision of the institution, including whether Prompt Corrective Action (PCA) requirements under Section 216 were properly implemented.

03 Make appropriate OBSERVATIONS and RECOMMENDATIONS to NCUA management to prevent future losses to the Share Insurance Fund.

📋 HOW THE MLR IS CONDUCTED

Review Analyze NCUA and State Supervisory Authority (SSA) examination reports, supervision files, and all related correspondence.

Interview Interview key management and staff from NCUA headquarters, regional offices, and State Supervisory Authorities.

Analyze Review NCUA policies and procedures, 5300 Call Reports, and Financial Performance Reports (FPRs).

Report Issue findings, observations, and formal recommendations to NCUA management for corrective action.

MLR TRIGGER SEQUENCE — From Credit Union Failure to Final OIG Report

1. **Financial Deterioration** — CAMEL ratings decline; DORs issued; PCA levels triggered
2. **NCUA Conservation** — NCUA Board conserves the credit union to protect members
3. **Liquidation Order** — Regional Director executes Order of Liquidation; AMAC appointed agent
4. **Loss Calculated** — Projected NCUSIF loss determined — if ≥$25M + 10% of assets, MLR is mandatory
5. **OIG Engagement** — OIG initiates MLR — may use outside contractor (e.g. National Firm)
6. **Fieldwork & Analysis** — Exams reviewed, interviews conducted, Call Reports analyzed
7. **Report Issued** — Findings, observations, and recommendations published publicly

$2.29 Million Loan Lapping Scheme

Indianapolis' Newspaper Federal Credit Union | CEO, Staff & Board Chairman | Liquidated March 2021

$2.29M
Estimated Loss to Share Insurance Fund

$1.3M
Fraudulent Loans in Lapping Scheme

47%
Peak Loan Concentration to One Household

4 Years
Consecutive Net Losses Before Failure

THE SCHEME
CEO, two staff, and Board Chairman executed a loan lapping scheme — using fraudulent loan advances to cover existing loan payments, concealing delinquencies for years.

THE CONDUCT
Falsified signatures, forged credit reports, backdated loan documents, waived fees for insiders. CEO admitted to signing her deceased mother's name to obtain loan disbursements.

THE OUTCOME
All staff terminated; Board Chairman resigned. Net worth dropped from 9.20% to negative 1.88% in one quarter. Conserved January 2021, liquidated March 31, 2021.

$40 Million Embezzlement

CBS Employees Federal Credit Union | CEO Edward Rostohar | Sentenced 2019

14 Years	20 Years	$40M	$200K
Federal Prison Sentence	Duration of Embezzlement Scheme	Total Stolen from Members	Cash Found in Trunk at Arrest

THE CRIME Forged checks and unauthorized online transfers over two decades — exploiting his former role as a federal examiner.

THE SPENDING Gambled away much of the funds; remainder spent on private jets, luxury cars, and expensive watches.

THE OUTCOME Credit union forced into insolvency and liquidation. Assets absorbed by University Credit Union. Pleaded guilty to bank fraud.

Source: U.S. Department of Justice | United States v. Rostohar | For Educational Purposes

Recurring Failure Patterns

	Management Actions Contributing to Failure						Supervisory Shortcomings	
Credit Union	**Ineffective Management**	**Concentration Risk**	**New Program or Services & 3rd Party Due Diligence**	**Liquidity Risk**	**Credit Risk**	**Member Business Lending**	**QCR Deficiency**	**Poor Examination Procedures**
Huron River	✓	✓	✓	✓	✓	✓		✓
Norlarco	✓	✓	✓	✓	✓	✓		
New London	✓	✓					✓	✓
High Desert	✓	✓			✓	✓	✓	✓
Center Valley	✓	✓						✓
Cal State 9	✓	✓	✓	✓	✓	✓		✓
Eastern Financial Florida	✓	✓	✓	✓	✓	✓		✓
Clearstar	✓	✓	✓	✓	✓	✓		✓
Ensign	✓	✓	✓	✓	✓	✓		✓
St. Paul	✓	✓		✓	✓	✓	✓	✓
Count (of 10):	10/10	10/10	6/10	7/10	8/10	8/10	3/10	9/10

Huron River · Norlarco · New London · High Desert · Center Valley

Credit Union	What They Did Wrong	What Should Have Been Done	Outcome
Huron River Area CU	Concentrated 84% of assets in out-of-state (Florida) construction loans via third-party CLC with no oversight. Violated MBL limits by 4x. Failed to disclose program to examiners.	Conduct due diligence on CLC. Implement concentration limits. Disclose new programs to examiners. Monitor loan performance quarterly.	Conserved Feb 2007. $25M+ loss to NCUSIF. Fraud by third-party vendor.
Norlarco Credit Union	Delegated full control of $30M/month construction program to third-party First American. 97% of assets in one geography. MBL balance secretly 3x statutory limits after reclassification.	Retain oversight of all lending decisions. Diversify geographic exposure. Independently verify MBL classifications. Require third-party audits.	Liquidated. Significant NCUSIF loss. Misclassified MBLs concealed true risk.
New London Security FCU	94% of assets held in investments. CEO/account manager ran embezzlement fraud undetected. No investment controls, no safekeeping agreement, no examiner rotation.	Implement investment controls checklist. Require safekeeping agreements. Rotate examiners regularly. Expand review when >50% assets in single category.	Failed due to fraud. Significant member losses. Examiner rotation failures cited.
High Desert Federal CU	Grew from $60M to $180M assets on real estate construction loans (60%+ of portfolio). Same two examiners for 8+ years. Stated income, no income verification, LTV violations.	Mandatory examiner rotation every 3 years. Expand procedures on repeat DOR issues. Require income verification on all real estate loans. Set concentration limits.	Liquidated. Examiner familiarity created systemic blind spots. Losses exceeded $25M.
Center Valley Federal CU	CEO committed embezzlement fraud. Weak internal controls across the entire operation made fraud easy to conceal. Examiners failed to assess transaction risk or internal control environment.	Regular internal control assessments. Dual-authorization for all executive transactions. Background checks and fidelity bond coverage. Independent supervisory committee audits.	Failed due to CEO fraud. Involuntary liquidation. NCUSIF loss incurred.

Cal State 9 · Eastern Financial Florida · Clearstar · Ensign · St. Paul Croatian

Credit Union	What They Did Wrong	What Should Have Been Done	Outcome
Cal State 9 Credit Union	Grew indirect HELOC portfolio 7,661% in 4 years to \$357M (92% of loans). Nearly all HELOCs had subprime elements: stated income, high CLTVs, low credit scores, negative amortization first mortgages.	Limit HELOC portfolio to prudent concentration thresholds. Require full income documentation. Set maximum CLTV limits. Respond to rapid growth with expanded exam scope.	Liquidated. One of the largest NCUSIF losses in the review. Subprime exposure devastating in 2008 downturn.
Eastern Financial Florida	Invested \$149M in complex CDOs backed by HELOC ABS in just months. Funded short-term. Commercial loan portfolio exceeded federal limits. Management lacked expertise to understand instruments they purchased.	Require board-level understanding of all investment instruments before purchase. Prohibit leverage strategies that exceed net worth thresholds. Examiners should require proof of management competency.	Liquidated. CDO portfolio became worthless. NCUSIF loss exceeded \$50M. Management cited for inadequate expertise.
Clearstar Financial CU	Grew indirect auto/RV loans to 54% of portfolio via CUDL with liberal underwriting — loaning to poor-credit borrowers, modifying classification matrices to approve higher-risk loans. Liquidity fell below Nevada's 5% minimum.	Maintain underwriting standards even during growth phases. Set hard concentration limits on indirect lending. Enforce statutory liquidity minimums. Prohibit making MBLs while undercapitalized.	Liquidated. Violated MBL rules while undercapitalized. Examiner enforcement failures cited as contributing factor.
Ensign Federal Credit Union	75% concentration in real estate loans. HELOC loans at 100% LTV. 40-year mortgage terms. Single \$12M trust deposit as primary funding — when withdrawn, credit union was insolvent.	Diversify funding sources. Cap LTV on HELOC programs. Reduce real estate concentration over time through enhanced underwriting. Examiners must act on concentration DORs, not just note them.	Purchase and assumption November 2009. Repeat DOR violations never escalated to enforcement action.
St. Paul Croatian FCU	CEO ran alleged fraud scheme: fraudulent share-secured loans made up 88% of total loans and 90% of total assets. No MBL policy. Board and Supervisory Committee provided no meaningful oversight.	Independent supervisory committee audits. Mandatory MBL policy. Examiners must expand procedures when share-secured loans represent abnormal concentrations. Enforce examiner rotation requirements.	Involuntary liquidation. CEO fraud destroyed virtually all assets. Board and Supervisory Committee failures fundamental cause.

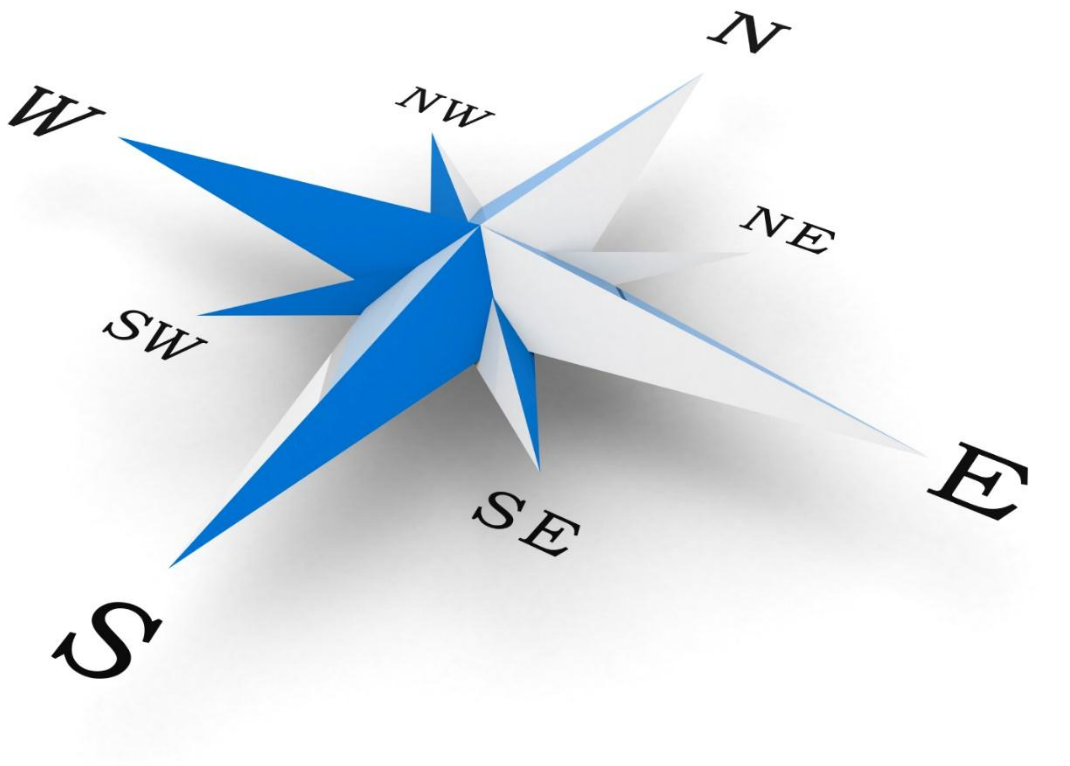
Cross-Cutting Themes, OIG Findings & 12 Recommendations

⚠ ROOT CAUSES	🔍 EXAMINER FAILURES	✓ OIG RECOMMENDATIONS
Management failure present in ALL 10 MLRs	Examiners did not rotate — same team for 8+ years at High Desert	1–4: Require documented CAMEL rating reviews; quarterly Call Report monitoring with triggers
Poor strategic planning & new program due diligence	Quality control reviews not followed through	5–7: Establish concentration limits; develop trigger reports; require unfunded commitment breakouts on Call Reports
Concentration risk in ALL 10 MLRs	Repeat DOR issues never escalated to enforcement	8–9: Re-emphasize third-party due diligence guidance; develop new program examination guidance
Credit risk in 8 of 10 MLRs	Examiners relied too heavily on management representations	10–11: Standardize QCR process nationally; require SE written responses to QCR findings
Liquidity risk in 7 of 10 MLRs	Expanded procedures not triggered despite red flags	12: Escalate enforcement on repeat DOR violators — examiners must act, not just document
Fraud in 3 of 10 MLRs (1 confirmed, 2 alleged)	CAMEL ratings too lenient despite mounting risks	NCUA agreed with all 12 recommendations
Member Business Loan violations in 7 of 10	Liquidity trends not analyzed as a group across ratios	New national supervision manual planned
Third-party oversight failures in 6 of 10	Off-site Call Report monitoring was inadequate	AIRES redesign to identify fast-growing programs

10/10	10/10	3	12	100%
Had Management Failures	Had Concentration Risk	Involved Fraud	OIG Recommendations Issued	NCUA Agreement Rate

Determining the Audit Plan

- Determining the audit plan—and what is included on it—becomes increasingly critical as a credit union grows. Smaller credit unions typically begin with the required audits, then expand their audit plans to include areas they believe are important.
- However, many do not conduct an Enterprise-wide Risk Assessment (ERA). This assessment is required by the Institute of Internal Auditors and is increasingly being emphasized by examiners.
- An ERA involves a comprehensive review of all departments, products, and services within the credit union. The results rank risks and auditable areas by importance, enabling the Chief Internal Auditor and the Supervisory Committee to prioritize and determine which areas should be reviewed each year.

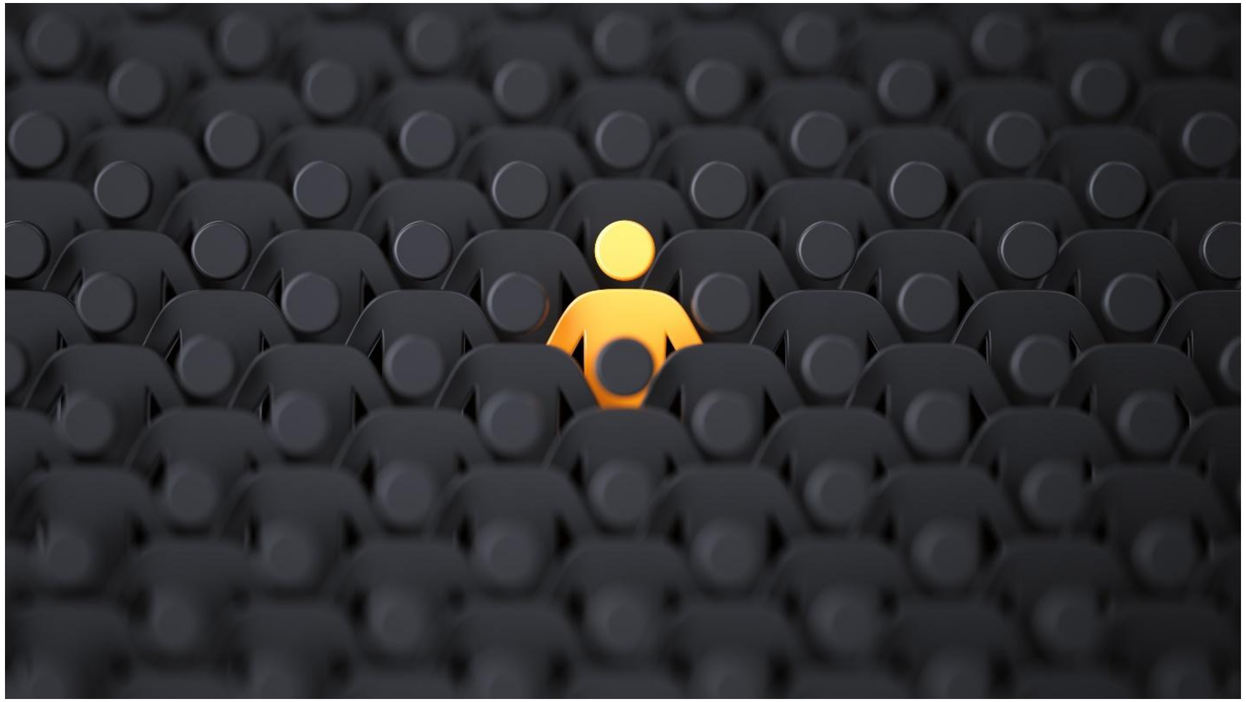


Internal Audit Program Development

- Identify key risks
- Monitor risk management processes
- Cybersecurity & fraud risks
- Align with enterprise risk management
- Required Audits
  - ✓ AUP or Financial Statement Audits
  - ✓ BSA Audit
  - ✓ ACH Audit
  - ✓ SAFE Act Audit
  - ✓ IT Audit

Internal Audit Function

- Approve audit plan
- Review findings
- Ensure independence
- Track remediation progress



The IIA framework consists of 33 performance standards covering all aspects of running an Internal Audit department. The following are some of the areas the standards cover:

- Documenting Engagement Planning / Scope / Objectives
- Communication and Approval protocols
- Policies and Procedures / Documentation / Supervision Standards
- Coordination and Reliance
- Reporting protocols
- How to use External Service Providers
- Governance
- Risk Management

Regulatory & Compliance Oversight

Balance Sheet Management

Lending

Loan growth has moderated in recent years, while loan performance has declined. The overall delinquency rate and rolling 12-month loss rate within federally insured credit union loan portfolios is at its highest point in over a decade. Asset quality deterioration and elevated loan losses remain material contributors to balance sheet stress, especially where higher-cost funding such as share certificates and borrowings limit margin recovery.

To assess lending practices and overall credit risk, NCUA examiners will focus on credit union lending and related risk-management practices. NCUA examiners will review portfolio monitoring, including the management of any material credit risk concentrations. When lending, servicing, or collection functions are outsourced, examiners will also assess third-party risk-management practices as appropriate.

Balance Sheet Management

Sensitivity to Market Risk and Liquidity

Sensitivity to Market risk, particularly Interest Rate Risk (IRR), and Liquidity risk remain key supervisory priorities as credit unions continue to adjust to a higher-rate environment following an extended period of balance sheet expansion and repricing. While recent declines in interest rates have lessened some pressures, elevated funding costs, asset quality challenges, and structural liquidity constraints continue to affect earnings and balance sheet resilience. In this environment, replacing defaulted or lower-yielding assets has become more challenging, increasing reliance on higher-yielding loans, and heightening sensitivity to both upward and downward rate movements. While interest rates have begun to decline, many loans and funding costs have not yet fully repriced, resulting in continued, albeit less, pressure on consumers compared with peak rate levels.

NCUA examiners will continue to review a credit union's ability to identify, measure, monitor, and control interest rate and liquidity risks through sound modeling practices, reasonable assumptions, and appropriately tiered scenarios. Reviews will focus on how credit unions incorporate these risks into governance frameworks, contingency funding plans, and strategic decision-making, including alignment between balance sheet structure, funding composition, and risk appetite.

Balance Sheet Management

Earnings and Capital Adequacy

Earnings and capital adequacy remain central supervisory priorities as asset quality pressures, elevated funding costs, and interest rate risk volatility continue to affect balance sheet performance. Asset quality deterioration and higher allowance expenses remain the primary drivers of earnings pressure, while elevated funding costs constrain margin recovery and capital accumulation. Although regulatory capital levels, as measured by the net worth ratio, have improved for many credit unions, earnings have shown less resilience. Further, equity capital continues to reflect unrealized losses associated with long-duration securities credit unions acquired during the recent low-rate environment, which may limit balance sheet flexibility under stress.

When evaluating a credit union's earnings, NCUA examiners will assess whether the current and prospective sources of earnings are sufficient to support capital targets under a range of interest rate, credit, and liquidity stress scenarios. NCUA examiner reviews may focus on policies, procedures, risk limits, and capital planning practices, including how credit unions incorporate interest rate risk, funding constraints, and concentration risks into their capital adequacy assessments. This supervisory approach will emphasize forward-looking analysis aligned with a credit union's size, complexity, and risk profile.

Operational Risk Management

Payment Systems

The payments environment continues to evolve rapidly as consumer expectations shift toward more efficient methods that provide for immediate access to funds and funds transfers.

Payment systems rely on increasingly complex integrations of applications, information systems, interfaces, security features, and internal controls. This complexity introduces the potential for added operational and security risk exposures. The risks of fraudulently induced payments, illicit use of consumer data, and cybersecurity breaches targeting payment systems continue to grow.

NCUA examiners will continue to assess whether credit unions have effective governance, risk assessments, vendor management, and security frameworks in place to support payment system operations, protect member data, and ensure resilience against fraud and cyber threats inherent in payment ecosystems.

Operational Risk Management

Fraud Prevention and Detection

Fraud remains a pervasive and elevated risk in the U.S. financial system. NCUA examiners will continue to review credit union efforts to deter and detect fraud, including the adequacy of internal controls and separation of duties to guard against insider abuse.

In 2026, the agency will review its examination procedures to ensure internal control and other review areas align with the ever-changing fraud landscape. NCUA will continue to work with key stakeholders in the credit union, regulatory, and law enforcement communities to enhance fraud prevention and detection awareness and capabilities where possible.

Compliance Risk Management

Bank Secrecy Act (BSA) Compliance and Anti-Money Laundering / Countering the Financing of Terrorism (AML/CFT) Programs

The BSA landscape will continue to evolve throughout 2026. The Financial Crimes Enforcement Network (FinCEN) and the federal financial institution regulators, including NCUA, continue to implement provisions of the Anti-Money Laundering Act of 2020 designed to modernize and strengthen the U.S. AML/CFT regime. Concurrently, FinCEN and the regulators will continue to evaluate ways to reduce BSA compliance burdens while helping financial institutions maintain effective, risk-based AML/CFT programs.

Significant developments and changes in the regulatory system are expected in 2026. NCUA will notify credit unions of regulatory changes, and credit union personnel may also sign up to receive FinCEN Updates. Regardless of the notification method, credit unions should stay informed to ensure their BSA policies, procedures, internal controls, and overall AML/CFT programs remain in compliance with changes.

The emphasis in 2026 will be on evaluating your credit union's risk-based approach to BSA compliance and how well the AML/CFT program is tailored to the credit union's specific risk profile. NCUA examiners will consider whether credit unions focus their resources on the areas of greatest money laundering and terrorist financing risk and whether policies, procedures and controls are effective at mitigating illicit financial activity risks.

Best Practices

- Maintain independence
- Regular meetings
- Continuous education
- Clear communication with management
- Strong documentation

- Structured agendas
- Focused discussions
- Pre-read materials
- Action tracking

- Primary source by which examiners evaluate the Committee and its actions
- Should support conclusions reached by the Committee Members
- Enable the examiner to evaluate how the perform their job responsibilities
- Can help protect the volunteers

Best Practices – Do's and Don'ts

Do

- Attend meetings
- Ask questions at meetings
- Object if you feel appropriate
- Act as a group

Do Not

- Become personally involved with staff
- Become involved in personnel decisions

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thank you

At this time we welcome your questions.

About TWHC

Turner, Warren, Hwang & Conrad AC (TWHC), based in Los Angeles, California, is a full-service CPA firm built on principles that ensure its clients receive value. TWHC was established in 1987, and its charter partners all worked together at a previous firm that was driven by similar principles.

TWHC has a diversified clientele. In addition to traditional individual and small business tax services, the firm has three specialty practices: Financial Institutions, Gaming, Retirement Plans and Not-For-Profit. TWHC employs over 70 employees who provide our clients with best-in-class service. This, in turn, helps our clients to meet their objectives.

For three decades, TWHC has developed numerous services to help its clients improve their operations and take advantage of efficiencies that they may not otherwise be aware of.

The firm continues to celebrate its heritage by adding to its long list of distinguished clients who have tried large firms but were not able to receive the level of service they were looking for. Today, TWHC is recognized in various markets as being the largest provider serving that market.

TWHC has been able to accomplish this because of its core values and the fact that it never takes its eye off of what is most important: the client. With two offices, one in San Francisco and one in Los Angeles (Burbank), TWHC serves clients all over the United States.

The most valuable capital that TWHC has is its loyal clients, who themselves are very aware of what is best for their companies. The most valuable support for TWHC is its work force and its tradition of outstanding service.

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