

DOCUMENT RESUME

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[H.R. 2176, a Bill to Amend the Accounting and Auditing Act of 1950 to Provide for the Audit of the Federal Reserve Board and Banks, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency]. March 2, 1977. 15 pp. + 1 enclosure.

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H.R. 2176 provides for GAO auditing of the three independent banking institutions; an act long advocated by GAO. Because of objections raised by the institutions concerning the possibility of such an audit hampering their independence, GAO has suggested several restrictions on its authority. It will not object to being restricted from making recommendations on the economic effects of open market and discount operations, or from auditing foreign central banks. GAO also suggests that language be included in the bill to exclude it from the Congressional prerogative of disclosure of borrowers' names. H.R. 2176 would provide for the much needed authority to have access to FDIC's bank examination records, previously unattainable. The bill is well written in regard to the mechanics of the audit operations, which are left to GAO's discretion. The rules set down in Accounting and Auditing Act of 1950 would be followed. The three institutions do perform some auditing activities on their own, but no complete audit is done. GAO's audit includes (1) examination of financial transactions, accounts, and reports, including an evaluation of compliance with applicable laws and regulations; (2) review of efficiency and economy in the use of resources; and (3) review to determine whether desired results are effectively achieved. No additional authority is needed for GAO to hire personnel to complete the audit functions. (SS)

00319

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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STATEMENT OF
ELLSWORTH H. MORSE, JP.
ASSISTANT COMPTROLLER GENERAL OF THE UNITED STATES
BEFORE THE
COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

on

H.R. 2176, A Bill to amend the Accounting and Auditing Act of 1950 to provide for the audit, by the Comptroller General, of the Federal Reserve Board, the Federal Reserve banks and their branches and check clearing, wire transfer, and security facilities, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency.

We appear here today at your invitation to present our views on H.R. 2176 which authorizes and directs the Comptroller General to audit the Federal Reserve Board, the Federal Reserve banks, branches and facilities, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency.

The bill provides authority to make comprehensive audits of the operations of the three named bank supervisory agencies. Two restrictions are provided:

1. The audits will not include transactions conducted on behalf of foreign central banks.
2. The audits will not include monetary policy deliberations and open market transactions conducted to promote maximum employment, production and purchasing power.

These three agencies carry out important functions in our system of government and regulation and we share the view that our Office, as an arm of the Congress, should be empowered by law to audit their operations.

As you know, the General Accounting Office recently completed a very comprehensive study of Federal supervision of State and national banks and our report on it was submitted by the Comptroller General to the Congress on January 31, 1977.

In transmitting the report, the Comptroller General stated that

"In the past we have supported proposals before the Congress to give this Office continuing legislative authority to review the operations of the bank regulatory agencies and report to the Congress. With such authority, we could be more helpful to the Congress in carrying out its legislative and oversight responsibilities for bank insurance and regulation. In view of the very important part that the three agencies play in the Nation's system of money and credit, we feel that the Congress should provide for GAO audits of the agencies."

H.R. 2176 provides such authority. However, we do have several suggestions to offer which in our opinion would strengthen the bill.

Federal Reserve System

Until 1933, our Office audited the expenditure vouchers of the Federal Reserve Board but not of the Federal Reserve banks. This very limited auditing had to be discontinued with the enactment of the Banking Act of 1933 which declared that the Board's funds were not to be construed as Government funds or appropriated moneys. Since that time, with one minor exception, we have not had audit authority with respect to the operations of the Federal Reserve System. The exception is the responsibility assigned by the act of May 20, 1966, to audit the cancellation and destruction of United States currency unfit for circulation.

H.R. 2176 provides that our auditing would not include open market transactions conducted by the Federal Reserve System. We strongly suggest that this restriction be modified.

The open market transactions are the largest category of financial transactions carried out by the System. During

the calendar year 1976, for example, outright purchases of U.S. Government securities and Federal agency obligations totalled over \$20 billion. At December 31, 1976, the Federal Reserve banks had on hand over \$100 billion in such securities--an increase during the year 1976 of nearly \$10 billion. These securities represented about 80 percent of the combined assets of the twelve Federal Reserve banks.

In addition to the large volume of transactions in Government securities, the Federal Reserve System also has very sizable purchases and sales of foreign currencies. These transactions are also carried out through the System Open Market Account under authorizations and directives of the Federal Open Market Committee. For calendar year 1976, for example, foreign currency purchases amounted to about \$900 million. At the end of the year, the System held \$170 million equivalent in such currencies.

We do not see how we can satisfactorily audit the Federal Reserve System without authority to examine the largest single category of financial transactions and assets that it has.

It is our understanding that the restriction in the bill that we would not audit monetary policy deliberations and open market transactions grows out of concern that our

auditing would somehow undermine the independence of the Federal Reserve System with respect to its monetary and credit operations and damage the Nation's monetary policymaking system. Needless to say, as we have testified on previous occasions, we do not concur in this view.

Should the Congress wish to restrict our auditing to take into account this concern, one restriction that could be written into the law--and the Comptroller General has gone on record on this before--would be to specifically provide that our audit reports to the Congress or its committees shall not contain conclusions or recommendations with respect to the economic effects (as opposed to the efficiency and economy) of open market and discount operations. We would have no objection to a restriction of this kind and we would be glad to work with the committee to draft appropriate language to cover it.

We also understand that there is concern about our auditing transactions conducted by Federal Reserve banks on behalf of foreign central banks because of their sensitivity from an international standpoint. We have no objection to the restriction on auditing these transactions as proposed in the bill, if the Congress wishes to prescribe one.

Federal Deposit Insurance Corporation

The General Accounting Office has been authorized for many years to audit the financial transactions of the Federal Deposit Insurance Corporation. This authority is in the Federal Deposit Insurance Act which became law in 1950.

We have had a long-standing disagreement with the FDIC on the scope of the auditing authorized by this law. Over the years the Corporation took the position that it does not authorize us to review its bank examination activities and records, whereas we have taken the view that we cannot satisfactorily audit the accounts, financial transactions and financial statements of the Corporation without having access to such records.

One result of this disagreement has been that in reporting to the Congress on our audits under the Federal Deposit Insurance Act, we have had to describe them as limited to such an extent that we could not say that the Corporation's financial statements presented fairly its financial position and results of operations. Our reports also recommended each year that the Congress clarify the law but this has never been done.

In our recently concluded special examination of Federal supervision of commercial banks by the Federal Reserve Board, the Comptroller of the Currency, and the FDIC--made at the

request of several congressional committees including this one--we worked out special arrangements with the three agencies for access to their bank examination records with agreed upon safeguards to preserve their confidentiality. The experience with this arrangement was such that the Chairman of the FDIC wrote to us recently proposing a 3-year trial period under which their bank examination records would be made available to us in connection with our annual audit of the Corporation's accounts and financial statements in accordance with terms consistent with those agreed upon for the special study last year.

We were very pleased to receive this proposal and we are now trying to work out the details with the Corporation. One problem to be resolved is the fact that we will also need access to examination reports prepared by examiners of the Federal Reserve System and the Office of the Comptroller of the Currency which are in FDIC's custody.

The arrangement suggested by the FDIC is only temporary and despite how it works out the Corporation could terminate it after three years. We would much prefer that the issue be settled by law and the access to records provisions of H.R. 2176 would do this.

Office of the Comptroller of the Currency

GAO has never had authority by law to audit the Office of the Comptroller of the Currency which is located in the Treasury Department.

The operations of this agency are financed by assessments levied on the National banks. These funds are not considered Federal funds and therefore GAO's general audit authority over Federal agencies does not extend to this agency.

H.R. 2176 as drafted contains no restrictions on the proposed audit of this agency and we therefore have no further comments.

Access to Records

H.R. 2176 includes a clear statement of authority for GAO representatives to have access to the records of the three agencies for the purposes of the audits. The provision extends to "reports of examination of banks or bank holding companies from whatever source". This provision is desirable so as to remove any questions as to the audit authority proposed to be granted by the Congress.

In this connection, we do have an amendment to suggest. Section 1906 of Title 18 of the United States Code prohibits

bank examiners from disclosing the names of borrowers or the collateral for loans of banks examined by them, without having first obtained express permission of the appropriate bank supervisory agency or the board of directors of the bank. An exception to this criminal provision is made where disclosure is ordered by a court or the Congress. In order to avoid a conflict between O's proposed right of access to records that might disclose names of borrowers or the collateral for loans and the criminal provision prohibiting examiners from disclosing such information without express written consent, we suggest that section 1906 be amended to exclude disclosure to GAO from the scope of the provision.

Audit Procedures

H.R. 2176 provides that our audits would be made under such rules and regulations as we would prescribe. The frequency and nature of specific audit work is not specified but is left to our judgment. This is a highly desirable way to write the law.

Under the laws which assign audit authority and responsibility to the General Accounting Office, for most Federal agencies we have the flexibility to determine the

frequency as well as the scope of the auditing performed. These judgments are made in the light of congressional interests in specific activities and specific questions or problems as they become known to us and, as the Accounting and Auditing Act of 1950 already requires, after giving "due regard to generally accepted principles of auditing, including the effectiveness of accounting organizations and systems, internal audit and control, and related administrative practices."

In accordance with our regular policy, any rules or regulations that we would prescribe for auditing these agencies would specifically require our auditors to review and evaluate the nature and effectiveness of the organizations and systems of internal management control of the several entities of the Federal Reserve System, the Office of the Comptroller of the Currency and the FDIC in determining the nature and extent of GAO audit work to be performed. In particular, we would make a comprehensive review of the internal and external auditing already being done. This step is in conformity with generally accepted principles of auditing and is also essential in avoiding unnecessary duplication and expenditure of effort.

The reason for mentioning this point is to recognize that some auditing is now being done within these agencies. In the Federal Reserve System, it is our understanding that--

- A firm of independent certified public accountants makes an annual audit of the accounts of the Board of Governors and submits an opinion on the Board's financial statements which is included in the Board's annual report to the Congress. This audit does not embrace the Federal Reserve banks and their branches.
- The Board's staff of field examiners examines each Federal Reserve bank and branch once each year--this is a requirement of section 21 of the Federal Reserve Act.
- The annual examination of the Federal Reserve Bank of New York includes an audit of the accounts and holdings relating to the System Open Market Account and the foreign currency operations conducted by the New York bank under policy directives of the Federal Open Market Committee.
- Representatives of a firm of independent certified public accountants accompany the Board's examiners on their examination of one Reserve bank each year, to evaluate the adequacy of the examination procedures.
- Each Reserve bank has internal auditors who work on a year-round basis. Their work programs are reviewed by the Board's examiners.
- Several teams of operational analysts review the efficiency of operations and controls of each Reserve bank and branch about once every three years.

Except for the opinion of the CPA firm on the financial statements of the Board of Governors which is included in the Board's annual report, no reports on the auditing being performed within the Federal Reserve System are submitted to the Congress, to our knowledge.

The FDIC and the Office of the Comptroller of the Currency each have internal review systems that would also be reviewed and evaluated in determining the nature and scope of our auditing.

Under our standards for audit of governmental activities, the full scope of an audit should include:

1. An examination of financial transactions, accounts, and reports, including an evaluation of compliance with applicable laws and regulations.
2. A review of efficiency and economy in the use of resources.
3. A review to determine whether desired results are effectively achieved.

Examinations of financial transactions, accounts, and reports and compliance with applicable laws and regulations include performing enough analysis and verification work to arrive at opinions as to whether financial transactions

are carried out in accordance with applicable legal requirements and are properly accounted for and set forth in financial reports.

In reviewing matters of efficiency and economy, our objective is to find out whether the entities being audited give due consideration to conservation of resources and minimum expenditure of effort in carrying out their operations. We are interested in finding out whether there are unnecessary or inefficient or unjustifiably costly procedures, whether there is unnecessary duplication of effort, whether work is being performed which serves little or no useful purpose, whether equipment is being inefficiently used, whether there is overstaffing, and whether there are faulty buying practices which result in paying unnecessarily high prices or just buying too much.

In carrying out this kind of work, we do not try to arrive at overall opinions as to whether an organization is operating efficiently and economically; but we do try to identify problem areas and propose recommendations for greater

efficiency and economy. This kind of audit work also includes analyzing the causes of any inefficient or uneconomical practices which we find as a basis for proposing recommendations for improvement.

In reviewing the results of authorized programs or activities, our primary purpose is to find out whether the objectives contemplated by the authorizing body or bodies are being achieved. In other agencies of the Federal Government, we have gained a great deal of experience in making such reviews. The Congress has expressed a growing interest in obtaining reports from us on the results of this kind of audit work. The most recent general expression by the Congress on GAO auditing is in the Congressional Budget and Impoundment Control Act of 1974. This act provides that we shall review and evaluate the results of Government programs and activities carried on under existing law. These reviews may be made on our initiative, when ordered by either House of Congress, or when requested by any congressional committee having jurisdiction over the programs or activities.

As stated earlier, we would be agreeable to having a restriction included in this bill that we would not include in our audit reports conclusions or recommendations with

respect to the economic effects (as opposed to efficiency and economy) of the open market and discount operations of the Federal Reserve System. However, there are numerous other functions and activities of the Federal Reserve System on which evaluations of results achieved or effectiveness of operations could be made as a part of our audits. Some examples of these functions are listed in Attachment I to this statement.

Personnel Employment Authorization

H.R. 2176 proposes to give us additional authority to hire people either permanently or temporarily to enable us to carry out the required audits. We have considered this provision and concluded that, particularly in the light of the special hiring authority contained in the General Accounting Office Act of 1974, no additional authorization is needed in this bill.

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This concludes our statement, Mr. Chairman. We will be pleased to respond to the committee's questions.

EXAMPLES OF FUNCTIONS AND ACTIVITIES OF THE FEDERAL RESERVE SYSTEM SUBJECT TO EVALUATION OF EFFECTIVENESS OF RESULTS ACHIEVED AS PART OF INDEPENDENT AUDIT BY THE GAO

- Board of Governors supervision of Federal Reserve Banks.
- Supervision of member banks of the Federal Reserve System.
- Reserve bank advances to member banks and others.
- Issuance and retirement of Federal Reserve notes.
- Redemption of food stamps.
- Clearinghouse operations.
- Acting as despositaries and fiscal agents of the United States.
- Acting as fiscal agents of Government departments and agencies in guaranteeing loans made by banks and other private financing institutions to finance procurement of materials and services for national defense.
- Involvement in issue and redemption of U.S. Government securities.
- Regulating and supervising the foreign operations of U.S. commercial banks.
(12 U.S.C. 601-631)
- Administration of the Bank Holding Act which is designed to control bank holding company expansion and prevent the expansion of bank holding companies into businesses not related to banking. (12 U.S.C. 1841-1850)
- Approval of bank mergers. The Board shares this responsibility with the FDIC and the Comptroller of the Currency. The Board is required to approve mergers in which the acquiring, assuming, or resulting bank is a State member bank.
(12 U.S.C. 1828c)
- Establishing rules and regulations for carrying out the provisions of the Truth in Lending Act whose purpose is to assure meaningful disclosure of credit terms to consumers. Enforcement is shared with the other bank regulatory agencies and the Federal Trade Commission. (15 U.S.C. 1601)