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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

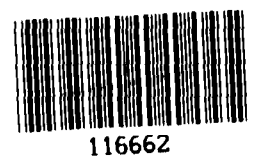
B-197162

OCTOBER 19, 1981

The Honorable Jake Garn
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

The Honorable William V. Roth, Jr.
Chairman, Committee on Governmental
Affairs
United States Senate

The Honorable Fernand J. St Germain
Chairman, Committee on Banking,
Finance, and Urban Affairs
House of Representatives



The Honorable Jack Brooks
Chairman, Committee on Government
Operations
House of Representatives

Subject: Financial Institution Regulatory Agencies Should
Perform Internal Audit Reviews of Their Examina-
tion and Supervision Activities (GGD-82-5)

The purpose of this report is to bring to your attention
a shortcoming in the internal audit activities of the Federal
financial institution regulatory agencies. The Federal regu-
lators' internal audit groups generally do not review and
evaluate the economy, efficiency, and effectiveness of their
agencies' examination and supervision activities. Significant
agency resources are devoted to these activities, and they are
an important function in each agency.

We have completed a series of reviews of the internal audit
organizations and functions at the Federal Deposit Insurance Cor-
poration, the Federal Home Loan Bank Board, the National Credit
Union Administration, the Federal Reserve System, the Office of
the Comptroller of the Currency, and the Farm Credit Administra-
tion. We conducted these reviews to ensure that the agencies'
activities were receiving adequate internal audit scrutiny. We
assessed each agency's internal audits against generally accepted
internal auditing standards formulated for private industry and
government. We enclose a listing of the resulting reports (see
p. 7).

FINANCIAL INSTITUTION REGULATORY AGENCIES
IMPROVED THEIR INTERNAL AUDIT ACTIVITIES

The internal audit operations of the financial institution regulatory agencies vary in size, organizational placement, and other factors. With the exception of identifying a common lack of internal audits of supervisory activities, the results of our assessments of each organization also varied. Since the completion of our reviews, each agency's use of internal audit has improved.

Federal Deposit Insurance Corporation

The Federal Deposit Insurance Corporation's Office of Corporate Audits has made significant progress toward achieving an effective internal audit function. We suggested six areas where the Office's operations and practices could be improved. These areas included the lack of written audit reports, report timeliness, and report clarity. In response to our report, the Corporation took steps to improve the Office of Corporate Audits' operations.

Federal Home Loan Bank Board

The Office of Internal Review of the Federal Home Loan Bank Board began to improve its internal audit operations before our review. However, we suggested that the Office should make a strong commitment to auditing the Board's data processing operations and should increase its guidance to the internal audit offices at each Federal Home Loan Bank. We also recommended that the Board strengthen its oversight of the Internal Review Office's activities. The Board issued guidance to the Federal Home Loan Bank internal auditors and improved its monitoring of its own internal audit activities. The Board also restructured its internal audit function into an expanded Internal Evaluation and Compliance Office.

National Credit Union Administration

We found that the National Credit Union Administration needed to give more support to its Office of Internal Audit and Investigation. The Office's responsibilities were broad, yet the size of its permanent staff was very small, which made it difficult for it to meet its responsibilities. Also, the Office's leadership changed frequently. In response to our report, the Office's staff was increased and a new office director was appointed who should provide managerial stability.

Federal Reserve System

Although two Board organizations and an external auditor make periodic reviews of the Board's operations, the Board of Governors of the Federal Reserve System does not have a permanent, independent internal audit group. Each Federal Reserve Bank has an independent internal audit staff. The Board disagreed with our recommendation to establish a permanent, independent internal audit group, but it did establish a permanent manager position for its Operations Review Group.

Office of the Comptroller of the Currency

The Office of the Comptroller of the Currency's internal audit organization was of a very small size relative to its responsibilities. Many activities and operations were left unaudited. We recommended that the internal audit organization's staff be increased. We also recommended several actions to improve the internal audit organization's operations. In response to our report, the Office doubled the size of its internal audit staff. The Office also took steps to implement our other recommendations.

Farm Credit Administration

The Farm Credit Administration did not have a permanent, independent internal audit group. Rather, internal audits were conducted by staff from two of its other organizations on a part-time basis. We recommended that a permanent internal audit group be established. We also recommended that the Administration provide guidance and support to the Farm Credit System's internal audit units and take other steps to improve internal auditing within the system. While the Administration has taken action to establish a permanent internal audit group, it rejected our other recommendations.

INTERNAL AUDITORS SHOULD REVIEW THEIR AGENCIES' EXAMINATION AND SUPERVISION ACTIVITIES

In each of the agencies we reviewed, examination and supervision of financial institutions are significant activities. Yet the agencies' internal auditors were generally not reviewing those activities. We believe that they should be reviewed.

To be of maximum usefulness, the scope of an internal auditor's activity should extend to all agency functions and related management controls. The full scope of an audit of a governmental program, function, activity, or organization should encompass

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

Because financial institution examination and supervision are major functions, the regulatory agencies' internal audit organizations should undertake reviews of the economy, efficiency, and effectiveness of these activities. The financial institution regulatory agencies have generally made progress toward establishing and maintaining internal audit organizations and have generally responded positively to the recommendations contained in our reports, but internal audit reviews of agency examination and supervision activities continue to be minimal. In four of the six agencies, no internal audit reviews of the examination and supervision activities have been performed in the last 3 years. The Federal Deposit Insurance Corporation and Federal Home Loan Bank Board, however, have conducted such reviews within the last year.

Agency officials cited insufficient auditing resources and inadequate expertise as the primary reasons for giving minimal attention to these areas. The Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency established separate operating review groups to perform evaluations of examination and supervision activities, but these groups faced either independence impairments or resource constraints that limited their scope of review.

A qualified, independent internal audit group provides management with a unique source of valuable information on performance. This information should include evaluations of economy, efficiency, and effectiveness of all significant agency activities. We believe officials of the financial institution regulatory agencies should be encouraged to increase their use of internal audit to review and assess the performance of examination and supervision activities.

AGENCY COMMENTS

While the agencies generally agreed in principle that supervision and examination activities should be reviewed by their internal audit units, five of the six agencies presented a wide

range of reasons for not fully using internal audit in this area, including lack of resources and use of other internal review groups. We continue to believe that the agencies should be encouraged to increase their use of internal audit to review examination and supervision activities. The agencies' comments are included in enclosures II through VII.

The Federal Deposit Insurance Corporation agreed that internal audit units should review supervision and examination activities. They noted that their internal auditor has issued several significant reports on activities in this area. (See enc. II.)

Although the Federal Home Loan Bank Board concurred with the "spirit and intent of the report" and reiterated its internal audit unit's progress over the last several years, the Bank Board asserted that its routine reviews of examination and supervision activities have been limited by staffing and workload considerations and GAO's extensive audit coverage of the area. We believe that the presence of GAO in an area should not exclude top agency management from continuing to use its internal audit to review areas of significant agency activity. Agency management, not GAO, has the primary responsibility for ensuring agency efficiency and effectiveness. While GAO's presence requires close coordination in order to ensure no duplication of effort, GAO's presence does not relieve agency management of its responsibilities. (See enc. III.)

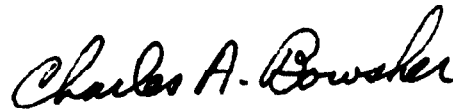
The National Credit Union Administration also agreed that internal audit should review supervision and examination activities. The Administration noted that a review of these activities is scheduled for October 1981. Unfortunately, this review has been scheduled twice before, only to be postponed because of lack of resources. (See enc. IV.)

The Federal Reserve Board agreed that internal audit organizations should review examination and supervision activities but did not agree with our assessment of their internal audit program. The Board believes that its ongoing internal review programs satisfactorily review examination and supervision activities. In addition, the Board notes that, subsequent to our study, individual Reserve bank internal audit units are now conducting reviews of their Reserve bank's examination and supervision activities, consistent with Board policy. Unfortunately, the Board has still not adequately addressed the concerns raised in our earlier report. At the Board level, no independent internal audit unit has been established. Instead, the Board continues to rely on a variety of internal review

organizations which suffer from either a lack of independent perspective or limited resources. The Reserve bank internal audit units review administrative aspects of the examination and supervision functions. They still do not review the efficiency and effectiveness of examination and supervision personnel as well as the end product of professional staff work. Our report on the Federal Reserve System's use of internal audit details our comments. (See enc. V.)

The Office of the Comptroller of the Currency continued to emphasize the use of other internal review groups to evaluate the efficiency and effectiveness of supervision and examination activities. Unfortunately, these groups suffer from either staffing constraints or independence impairments. In addition, the potential now exists for the duplication of effort between the internal audit unit and the other internal review groups. (See enc. VI.)

The Farm Credit Administration had "no suggestions to make regarding the substantive content of the report." However, the Administration did point out that its comments were not included in GAO's earlier report on the Administration's internal audit activities. We asked the Administration to comment on our earlier report, but it was unable to clear its comments with the Federal Farm Credit Board before the report was issued or within the maximum time permitted by P.L. 96-226. (See enc. VII.)



Comptroller General
of the United States

Enclosures

GAO REPORTS ON FINANCIAL
INSTITUTION REGULATORY AGENCIES'
INTERNAL AUDIT ACTIVITIES

<u>Title</u>	<u>Report number</u>	<u>Date issued</u>
The Office of The Comptroller of the Currency's Internal Auditing Needs Strengthening	GGD-80-8	11/09/79
Internal Auditing Needs More Support in the National Credit Union Administration	GGD-80-31	01/04/80
Opportunities to Further Strengthen Internal Auditing in the Federal Deposit Insurance Corporation	GGD-80-46	03/04/80
Opportunities to Further Improve Internal Auditing in the Federal Home Loan Bank Board	GGD-80-90	07/16/80
Internal Auditing Can Be Strengthened in the Federal Reserve System	GGD-80-59	08/08/80
How the Farm Credit Administration Can Improve Its Use of Auditing	GGD-81-22	01/28/81



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington D C 20429

OFFICE OF THE CHAIRMAN

September 11, 1981

Mr. William J. Anderson
Director, General Government
Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

We have reviewed your draft report entitled, "Financial Institution Regulatory Agencies Should Perform Internal Audit Reviews Of Their Examination and Supervision Activities." We are pleased that the conclusions of your report affirm the significant efforts made by the Corporation and the Office of Corporate Audits in establishing an effective internal audit function.

We are in agreement with your recommendation that the internal audit organization should review and assess the performance of examination and supervision activities. As stated in your report, the FDIC is one of two agencies whose internal audit organizations are already conducting such reviews. The audits of the examination and supervision activities which have been performed by our Office of Corporate Audits have been substantive and have provided a significant aid to Corporation management.

We will continue to encourage the use of our internal audit resources in the review of examination and supervision activities as recommended in your report.

Sincerely,

William M. Isaac
Chairman

Federal Home Loan Bank Board

RICHARD T. PRATT
CHAIRMAN



1700 G Street, N.W.
Washington, D.C. 20562
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

SEP 9 1981

Mr. William J. Anderson
Director, General Government Division
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Anderson:

This is in response to your letter of August 13, 1981, requesting our comments on your draft report entitled, "Financial Institution Regulatory Agencies Should Perform Internal Audit Reviews of Their Examination and Supervision Activities."

We concur with the spirit and intent of the report emphasizing the need for a qualified, independent internal audit group to provide management with a unique source of valuable information on all significant aspects of agency activities.

The Bank Board is committed to the development of an all encompassing and effective internal audit function. Over the past few years the Board has worked diligently toward meeting this goal. In January 1978, the internal audit responsibility was removed as a line management function and was established as an independent Internal Review Office reporting directly to the Chairman and Members of the Bank Board. Subsequently, in keeping with the intent of the Inspectors General Act of 1978, the Office's responsibilities were extended to include an investigative function and the Office was renamed the Internal Evaluation and Compliance Office to reflect this reorganization.

Recent initiatives of the Internal Evaluation and Compliance Office have included:

- The development and publication of a policy and procedures manual to govern the Office's administrative, audit and investigative operations;
- The distribution to all employees of a poster listing agency "hotline" telephone numbers as a part of a general awareness program for agency employees;

- The development of an annual audit plan, the process for which has been formalized and now provides for (a) involvement by agency management officials, and (b) publication and dissemination of the plan to inform agency official of (i) the work which has been planned, along with a proposed schedule for each job, and (ii) the basis or criteria used in the selection of each of the planned audits/surveys; and
- The initiation of a management review program to improve oversight and operations of the Internal Auditors of the 12 Federal Home Loan Banks. The implementation of the management reviews is significant because it sets in motion for the first time the application of a comprehensive and uniform set of review criteria/standards for all 12 Internal Audit Offices which will be carried out on a three-year cycle.

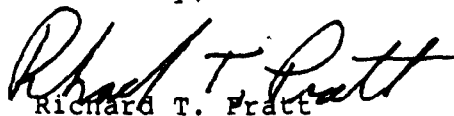
As indicated in the title of the report, it is vitally important that all financial regulatory agencies review and assess the performance of their examination and supervision activities. I am pleased you also noted in your report that the Bank Board's Internal Evaluation and Compliance Office conducts such reviews on a routine basis.

Since its inception in 1978, the Bank Board's audit office has been responsible for conducting audits of all significant areas of agency operations including the examination and supervision functions. The scope and frequency of such audits has, however, been limited as the direct result of: (1) extensive audit coverage provided to this agency's Office of Examinations and Supervision (OES) by the GAO; and, (2) our own staffing and workload considerations. As a result, we have reduced our normal audit coverage of OES so as not to duplicate the work of the GAO and rather, have concentrated our resources in other areas of the Bank Board.

In closing, I believe this agency's recent record in establishing the Internal Evaluation and Compliance Office demonstrates the importance we place on the independent audit function. You may be assured that our audit activities will continue to receive the full support of our top management personnel.

Please let me know if you have any questions or if I may otherwise be of service.

Sincerely,


Richard T. Pratt



NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

Office of the Chairman

September 8, 1981

Mr. William J. Anderson
Director
General Government Division
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Anderson:

We have reviewed the draft GAO report titled, "Financial Institution Regulatory Agencies Should Perform Internal Audit Reviews of Their Examination and Supervision Activities", and would like to offer the following comments.

We were pleased to observe that this report acknowledges the improvements which NCUA has made since GAO issued its report concerning NCUA's Office of Internal Audit and Investigation (1/4/80). However, in addition to the corrective actions noted in your report, we have committed significant portions of our FY 82 Internal Audit Schedule to the review of NCUA's Examination and Supervision Programs. An audit survey for these programs is scheduled to commence in October 1981. Contract assistance may be needed to supplement the internal audit staff in this effort. However, the Office of Internal Audit and Investigation will be solely responsible for managing the work.

In the future we hope to expand our internal audit staff to the extent that outside assistance will not be needed for the conduct of internal audits.

If any additional information is required, please contact myself or Mr. Louis P. Acuna, Director of the Office of Internal Audit and Investigation.

Sincerely,

A handwritten signature in cursive script, appearing to read 'Lawrence Connell', written in dark ink.

LAWRENCE CONNELL
Chairman



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 8, 1981

Mr. William J. Anderson
Director
General Government Division
United States General
Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

Thank you for the opportunity to review and comment on the draft General Accounting Office (GAO) report entitled, "Financial Institution Regulatory Agencies Should Perform Internal Audit Reviews Of Their Examination and Supervision Activities." As noted in your letter, this report summarizes the results of your reviews of the six financial institution regulatory agencies' internal audit operations.

The Board fully supports the GAO's belief that because financial institution examination and supervision are major functions, the regulatory agencies' internal audit organizations should undertake reviews of the economy, efficiency, and effectiveness of these activities. The Board is also pleased to note that the GAO in its report has recognized that each agency's use of internal audit has improved in recent months. In this connection, the Board wishes to note that all of the improvements mentioned in its October 7, 1980, letter to the Congress on the subject of the Federal Reserve's use of internal auditing either have been implemented or are in the process of final implementation.

With respect to the Federal Reserve System's use of internal auditing in the area of its supervision and regulation responsibilities, the Board wishes to note the following:

- o The Board has had for five years a review program consisting of Board staff to review the supervision and regulation operations of the Federal Reserve Banks from an effectiveness, economy, and efficiency standpoint. This program continues to demonstrate its usefulness as a managerial tool. While a review of this program was omitted from an earlier review of the division in which it is housed, our internal Operational Review Program fully intends to review it at the appropriate time;

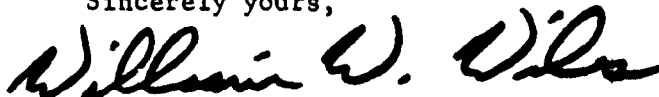
Mr. William J. Anderson

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- o In response to GAO's recommendation in its 1980 report on the Federal Reserve's use of internal auditing, the Board issued a policy statement on May 12, 1980, dealing with the review of the supervision and regulation functions of the Reserve Banks by the general auditors of the Federal Reserve Banks. Since that time, the Conference of General Auditors has developed a core program for auditing the area and several Federal Reserve Bank internal audit departments have conducted audits of their supervision and regulation activities; it is the Board's understanding that it is the intention of those remaining to conduct audits before the end of the year;
- o In 1978-1979, the Board's Operational Review Program undertook an extensive review of the Board's Division of Banking Supervision and Regulation from an economy, efficiency, and effectiveness standpoint. The GAO reviewed the results of this review and commented that the review produced useful recommendations; and
- o Again, in response to a GAO recommendation, the Board directed its Operational Review Program to perform follow-up reviews on all of its reviews. Under this new mandate, the Operational Review Program recently completed an extensive follow-up review of its 1978-1979 review of the Division of Banking Supervision and Regulation with favorable results.

We hope that the above will be helpful to you in tracking the Federal Reserve's progress in this important activity. We again thank you for the opportunity to comment on the draft report.

Sincerely yours,



William W. Wiles
Secretary of the Board



Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

September 16, 1981

Mr. William J. Anderson
Director
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

We appreciate the opportunity to respond to GAO's draft report entitled "Financial Institution Regulatory Agencies Should Perform Internal Audit Reviews of their Examination and Supervision Activities." The draft report summarizes the results of GAO's reviews of the six Federal financial institution regulatory agencies' internal audit operations.

The Office of the Comptroller of the Currency (OCC) received its final report on its internal audit function from GAO on November 9, 1979. In that report, GAO observed that our Internal Audit Division did not directly audit activities such as bank examinations and supervision policies and procedures. In our original response, we stated that this observation was ". . . not comprehensive. These important OCC functions have been under continual evaluation at both a policy and an operational level." This statement still is relevant almost two years later.

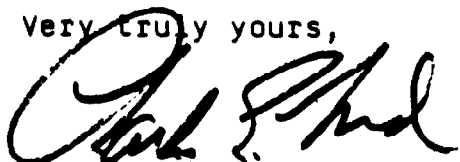
The OCC has established and begun staffing its Program Analysis Division. This division will assist the OCC in fulfilling its regulatory mandates in an efficient and effective manner by analyzing and evaluating major programs (such as the bank examination function) through cooperative and independent reviews. Also, within the Chief National Bank Examiner's Office, we have established a Bank Supervisory Analysis Division to assist the OCC in fulfilling its oversight responsibility by assuring a high level of quality control and the uniform application of examination policies and procedures. The division will evaluate the effectiveness of bank supervision policies, practices and procedures and will conduct periodic reviews of internal and external situations which may require new policies or revisions to existing examination and bank supervision policies and procedures.

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The OCC is very proud of the great strides made over the past few years in developing systems to determine bank supervision effectiveness and efficiency. New systems are being developed and others revised as necessary on a continual basis to assure a progressive examination and bank supervision function.

You can be assured of our continued cooperation with GAO in this important matter.

Very truly yours,



Charles E. Lord
Acting Comptroller of the Currency

Farm Credit Administration

490 L'Enfant Plaza
Suite 4000
Washington, DC 20578
(202) 755-2195

September 3, 1981



William J. Anderson, Director
General Government Division
U. S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

We have reviewed the draft report titled "Financial Institution Regulatory Agencies Should Perform Internal Audit Reviews of Their Examination and Supervision Activities" (GGD-81-90) and have no suggestions to make regarding the substantive content of the report.

We wish to call to your attention that the report (GGD-81-22) dated January 28, 1981, to the Governor did not contain Farm Credit Administration comments on the GAO recommendations. Our comments, which explained why some of the recommendations were rejected, were sent to the chairmen of the Senate Committee on Governmental Affairs and House Committee on Government Operations by letters dated March 20, 1981.

Sincerely,

Donald B. Wilkinson
Governor