BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MEMO

OFFICE OF INSPECTOR GENERAL

DATE: December 14, 2007

TO: Board of Governors

FROM: Elizabeth A. Coleman

SUBJECT: 2008-09 Proposed Budget for the Office of Inspector General

ACTION REQUESTED

Approval of the 2008-09 Budget for the Office of Inspector General as itemized below:

1. An operating budget of $12,679,950. This figure represents an increase of $2,442,270 for the biennium or about 11.4 percent annually. The budget provides for thirty-seven positions.

2. A capital budget of $81,800, an increase of $75,000 for the biennium.

DISCUSSION

The Office of Inspector General's proposed budget will allow us to continue our legislated mandate of conducting audits, investigations, and other reviews to help improve the economy, efficiency, and effectiveness of the Board's programs and operations and to help prevent and detect fraud, waste, abuse and mismanagement. Our operating budget includes an increase of 9.8 percent for personnel services that provides for succession planning, merit increases, and increases in retirement and insurance expenses. It also provides for one new position to serve as the assistant to the Division Director and to provide additional administrative and operational back-up support. Our budget includes an increase of $583,318 in goods and services that primarily reflects increases in three key areas: our new contract for the Board's financial statement audit and related internal control reviews; leadership and other training for succession planning and to develop and maintain a dynamic, highly-skilled workforce; and technological enhancements to support our information technology infrastructure and to enhance our overall analytical capabilities and communications. Our capital budget reflects a $75,000 increase to fund new software that will streamline our investigative operations and case management processes. Attached are more specifics on our budget request.

Our budget was prepared in a manner that is administratively consistent with the preparation of the Board's operating budget, but is submitted separately to reflect the independence of the office.

Inspector General's Analysis of the Budget Request
91011 Program Direction

Account Category	Base 2006-07	Requested Funding 2008-09	Difference	Average Annual Change
Salaries	7,805,875	9,378,079	1,572,204	9.6%
Retirement/Thrift Plan	813,484	1,056,218	242,734	13.9%
Employee Insurance	435,084	479,298	44,214	5.0%
Subtotal: Personnel Services	**$9,054,443**	**$10,913,595**	**$1,859,152**	**9.8%**
Travel Expenses	202,000	270,000	68,000	15.6%
Stationery & Supplies	8,500	9,450	950	5.4%
Software	50,200	119,400	69,200	54.2%
Furniture & Equipment	180,000	210,210	30,210	8.1%
Rentals	15,680	18,000	2,320	7.1%
Books & Subscriptions	600	1,900	1,300	78.0%
Repairs & Maintenance		2,500	2,500	
Contractual Professional Services	475,000	758,405	283,405	26.4%
Tuition/Registration&	191,500	302,160	110,660	25.6%
All Other	6,600	6,684	84	0.6%
Depreciation	14,489	37,949	23,460	61.8%
IRM User Change	38,468	29,697	-8,771.00	-12.1%
Subtotal: Goods & Services	**$1,183,037**	**$1,766,355**	**$583,318**	**22.1%**
Operating Funds	**$10,237,480**	**$12,679,950**	**$2,442,470**	**11.4%**
Capital Assets	**6,800**	**81,800**	**75,000**	**246.8%**

Inspector General's Summary and Highlights

During the upcoming budget period, the Office of Inspector General (OIG) will continue to carry out its overall legislated mission to conduct and supervise independent and objective audits, investigations, and other reviews to help improve the economy, efficiency, and effectiveness of Board programs and operations, and help to prevent and detect fraud, waste, and mismanagement. The OIG has developed a new strategic plan that outlines our long-range direction from 2008 to 2011, and delineates how we plan to carry out our roles and responsibilities. Overall, the OIG will direct its work to focus on risk, achieve results, and protect the public interest through an independent partnership with the Board, built on integrity, excellence, and professionalism. Our strategic goals are to

- conduct work consistent with the OIG's statutory and legislated requirements;
- broaden coverage of the Board's mission areas to enhance economy, efficiency, and effectiveness; limit risk; detect and prevent fraud and abuse; and ensure compliance; and
- enhance the efficiency and effectiveness of the OIG's operations and communications.

The OIG's 2008-09 operating budget request totals $12,679,950, which represents a total increase of $2,442,470 over the two-year period, or about 11.4 percent annually. Personnel costs continue to comprise about 86 percent of our total budget. Total personnel services for 2008-09 are $10,913,595, which is a total increase of $1,859,152 or about 9.8 percent annually. The budget provides for 37 positions, which is an increase of one position from the last budget cycle. This additional position will serve as an assistant to the Inspector General and will also provide back-up for the OIG's administrative operations. The budget also includes an increase of $75,000 in our capital budget to purchase and implement an off-the-shelf database software package to better support and streamline OIG investigations, and so leverage our limited investigative resources. Overall, the additional funding supports the following goals:

- **Strengthen our Human Resources Management**: To incorporate recommendations from the Board's compensation study, the budget includes an enhanced merit pool and increased cash awards and variable pay to help attract and retain high quality talent. In addition, the budget provides premium pay for 1811 senior criminal investigators who are at or below the FR-27 level, to bring us closer to the compensation packages offered by competing agencies and so enhance our ability to recruit and retain staff with these specialized skills.
- **Provide for Succession Planning and Career Development**: With both the Inspector General and Deputy Inspector General retiring during the last budget cycle and the eligibility of a large number of our senior officers to retire over the next five years, building our mid-level management structure and developing the next level of OIG leadership is a top priority. The budget includes funding for promotion opportunities to the manager level, with corresponding career progression to the senior level, for staff across the OIG program areas. It also provides for succession planning within the quality assurance and the legal services program areas by converting two existing officer positions to FR-level staff: one to a program manager to lead the quality assurance and

communications function and the other to an entry-level attorney position. To develop these new leaders and to identify and develop the skills required to maintain a dynamic, highly-skilled workforce across the OIG, the budget provides an additional $110,660 for external training and development courses over the two-year period.

- **Contract for the Board's Financial Statement Audit**: The 2006-07 budget marked the close of a 5-year contract with one independent public accounting (IPA) firm, and the acquisition of a new IPA for 2007 and beyond to conduct the audits of the Board, the System, and the Office of Employee Benefits (OEB). Under this contract, the OIG funds the cost of the Board's financial statement audits, which will total $410,000 for the 2008-09 budget period, an increase of $260,000 over the 2006-07 budgeted amount. This $410,000 cost includes an audit of the design effectiveness of the Board's internal controls over financial reporting for the year ended December 31, 2007, and a walk-through of the design and operating effectiveness of the Board's internal controls over financial reporting to assess the Board's readiness to meet the requirements of Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 5 (AS5).

- **Provide Enhanced Software Tools and Capabilities**: The budget includes an additional $69,500 for software enhancements and maintenance, including various tools to maintain and secure the OIG Information Technology (IT) infrastructure, new capabilities to assist in extracting and analyzing data, and blackberry capability for our new management staff. The capital budget provides $75,000 for new software to provide enhanced capability and efficiencies for our investigations program.

To help put the 2008-09 budget in perspective, the table below provides a historical comparison of the OIG's operating budget relative to that of the Board over the last seven budget periods.

Two-Year Period	OIG Budget	Board Budget	OIG Staff	Board Staff	OIG % Budget	OIG % Staff
1996 / 1997	$6,000,046	$326,693,918	32	1,746	1.84%	1.83%
1998 / 1999	$6,419,000	$352,255,000	29	1,711	1.82%	1.69%
2000 / 2001	$6,617,000	$389,758,000	29	1,699	1.70%	1.71%
2002 / 2003	$7,757,000	$465,988,000	29	1,884	1.66%	1.54%
2004 / 2005	$8,533,000	$527,809,000	31	1,948	1.62%	1.59%
2006 / 2007	$10,237,480	$609,500,000	36	1,976	1.68%	1.82%
2008 / 2009	$12,697,950	$706,300,000	37	2,036	1.80%	1.82%

In total, the OIG's 2008-09 budget and staffing levels remains at less than two percent of the Board's projected budget and staffing levels. Even with the budget increase in the 2008-09 period, the OIG's budget and staffing level as a percentage of the Board is essentially the same percentage that we had back in the 1996-97 budget period.

We recognize that changing events may lead to supplemental budget requests that we cannot estimate at this time. Like the Board, the OIG also faces uncertainties about other legislative requests and mandates which may require unanticipated work. Additionally, a significant number of bank failures could trigger our mandated material loss reviews. While we

generally suspend other work to perform these reviews, this approach may not be feasible should we receive a number of relatively concurrent failures coupled with continued congressional and legislated requests. Finally, the Federal Bureau of Investigation (FBI) continues to focus its work on homeland security issues and is increasingly looking to the IG community to perform investigative work that was previously performed by the FBI. Our workload has already increased during the current budget period and we will inform the Board if this work further impacts our operations.