



# **Semiannual Report to Congress**

**April 1 – September 30, 2004**

**OIG**

Office of Inspector General





BOARD OF GOVERNORS  
OF THE  
**FEDERAL RESERVE SYSTEM**  
WASHINGTON, D. C. 20551

OFFICE OF INSPECTOR GENERAL

October 28, 2004

The Honorable Alan Greenspan  
Chairman  
Board of Governors of the Federal Reserve System  
Washington, DC 20551

Dear Chairman Greenspan:

We are pleased to present our *Semiannual Report to Congress* which summarizes the activities of our office for the reporting period April 1 through September 30, 2004. The Inspector General Act requires that you transmit this report to the appropriate committees of Congress within thirty days of receipt, together with a separate management report and any comments you wish to make.

Sincerely,

/signed/

Barry R. Snyder  
Inspector General

Enclosure





# **Semiannual Report to Congress**

**April 1 – September 30, 2004**

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## Introduction

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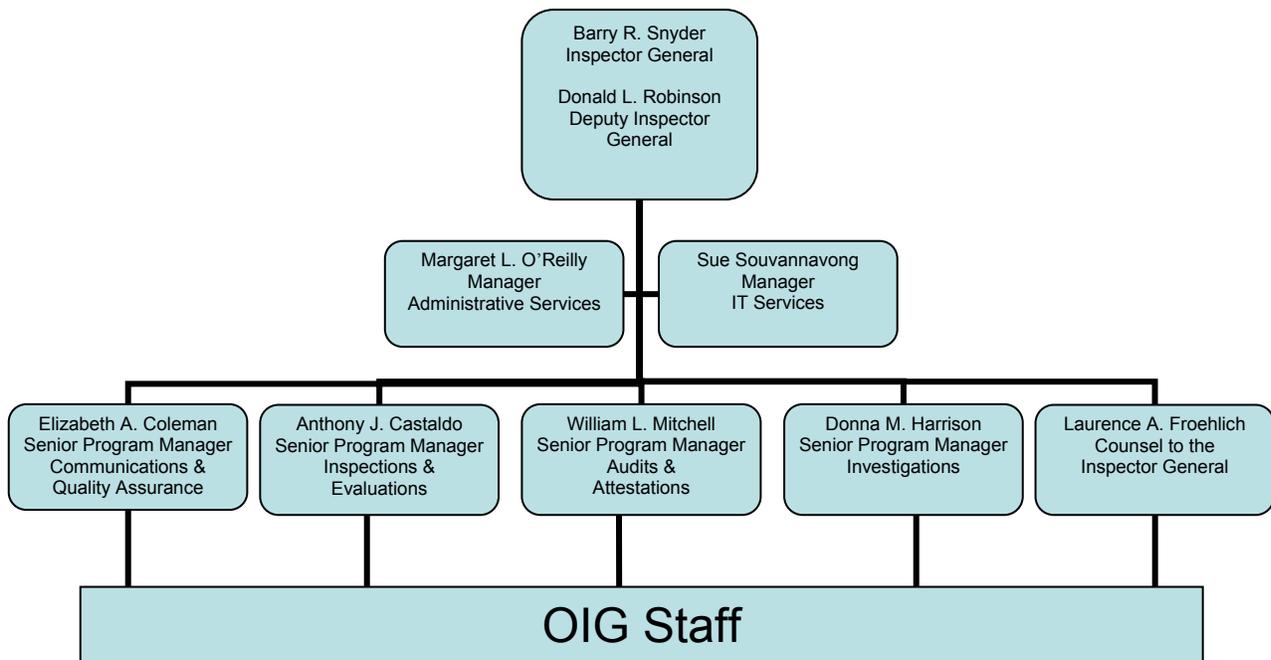
Consistent with the Inspector General Act of 1978 (IG Act), as amended, the mission of the Office of Inspector General (OIG) of the Board of Governors of the Federal Reserve System (Board) is to

- conduct and supervise independent and objective audits, investigations, and other reviews of Board programs and operations;
- promote economy, efficiency, and effectiveness within the Board;
- help prevent and detect fraud, waste, and mismanagement in the Board's programs and operations;
- review and make recommendations regarding possible improvements to existing and proposed legislation and regulations relating to Board programs and operations; and
- keep the Chairman and Congress fully and currently informed of problems.

Congress has also mandated additional responsibilities that have a significant impact on our resources and workloads. For example, the Federal Deposit Insurance Act (as amended) requires the Board's OIG to review failed financial institutions supervised by the Board that result in a material loss to the bank insurance funds and produce, within six months of the loss, a report that includes possible suggestions for improvement in the Board's banking supervision practices. In the information technology arena, the Federal Information Security Management Act of 2002 (FISMA) provides a comprehensive framework for ensuring the effectiveness of information security controls over information resources that support federal operations and assets. Consistent with FISMA requirements, we perform an annual independent evaluation of the Board's information security program and practices to include evaluating the effectiveness of security controls and techniques for selected information systems.

# Office of Inspector General

## September 2004

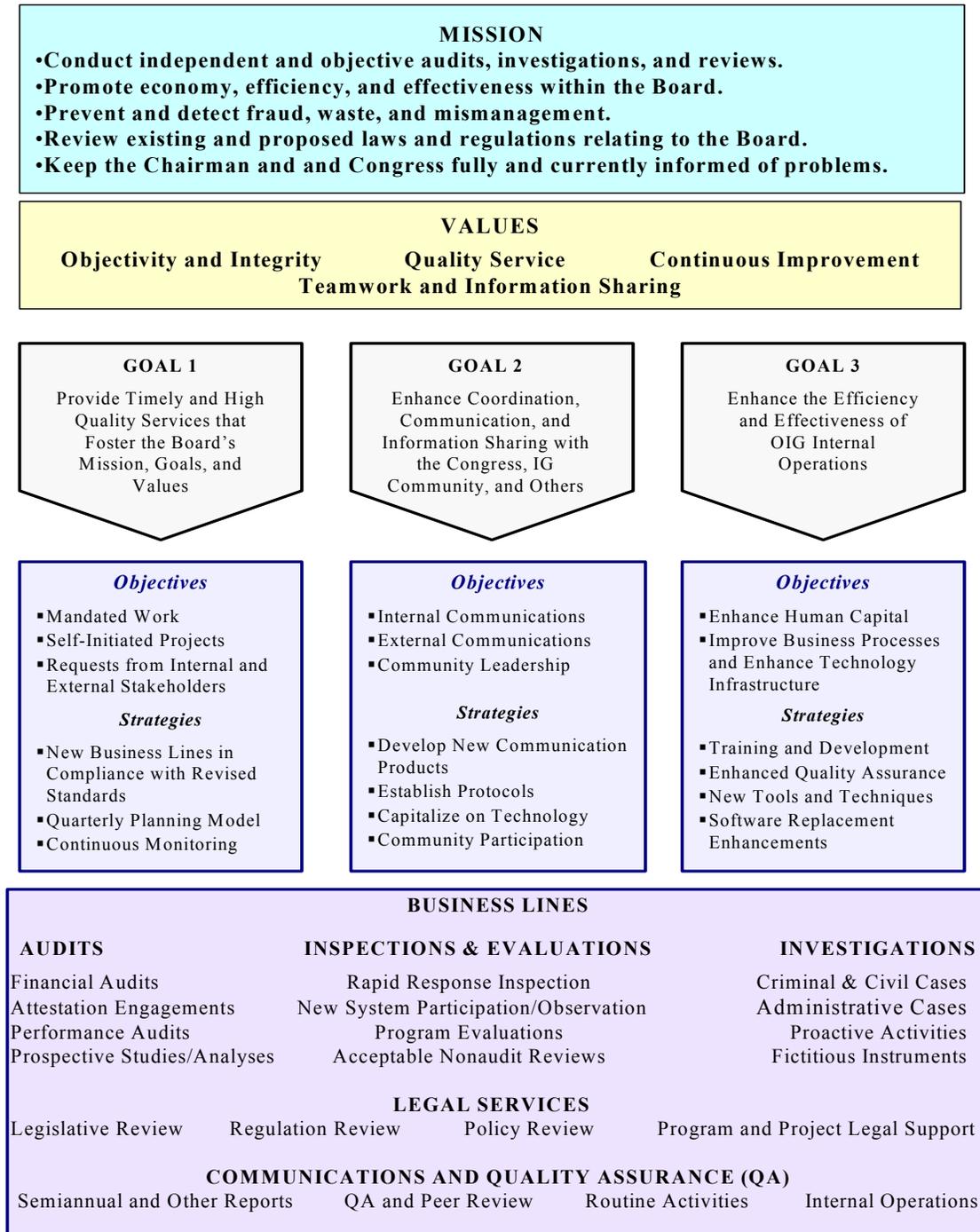


OIG Staffing	
<b>Auditors</b> .....	<b>15</b>
<b>EDP Auditors</b> .....	<b>5</b>
<b>Investigators</b> .....	<b>5</b>
<b>Attorney</b> .....	<b>2</b>
<b>Administrative</b> .....	<b>2</b>
<b>Information Systems Analysts</b> .....	<b>2</b>
Total Positions	31

# Goals and Objectives

The OIG has identified three strategic goals and developed corresponding objectives to guide our work over the next five years. For each strategic goal, we have also identified specific strategies to help achieve the underlying objectives. The exhibit below depicts the relationship of the various elements of our strategic plan, within the context of our mission and values.

## Overview of OIG Strategic Plan 2004 - 2007





## **Projects Completed during this Reporting Period**

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### ***Audit of the Board's Outsourcing Efforts***

During this reporting period, we completed our audit of the Board's outsourcing operations. We conducted this audit to assess the Board's management of contracts for outsourced services and to evaluate the process for identifying and evaluating other outsourcing and competitive sourcing opportunities.

Our audit identified a number of areas for improvement regarding the Board's outsourced activities that will require the efforts of the Board's Procurement Section, the divisions requesting services, and the Legal Division (Legal). Our audit report contains three recommendations designed to enhance the management of outsourcing contracts and the Board's overall outsourcing approach. Specifically, we recommended that the Management Division (MGT) enhance controls to ensure that statements of work and contracts for outsourced services specify the expected vendor performance, results, level of service, standards for performance measurements, and incentives or penalties, as appropriate, based on the actual level of vendor performance. We also recommended that Legal review all contracts involving outsourced services to help mitigate legal risks. Finally, we recommended that the Board develop a more proactive, strategic approach to outsourcing that is linked to workforce planning activities.

We provided a copy of our report to the Staff Director for Management and the General Counsel for review and comment. Their responses indicate concurrence, in part or in principle, with the recommendations and discuss actions, such as revising the Board's *Acquisition Policy*, that have been or will be taken to implement the recommendations.

### ***Evaluation of the Effectiveness of Administrative Controls over an Outsourced Contract***

Our work during the audit of the Board's outsourcing efforts included a detailed review of fifteen judgmentally selected contracts providing some level of outsourced services. One of the contracts we reviewed was for the acquisition of information security control reviews as part of the Board's implementation of the Government Information Security Reform Act. Because our initial review of this contract identified substantial increases in contract costs as well as potential weaknesses in the contracting and contract-modification processes, we decided to perform a more in-depth evaluation. This evaluation showed that the administrative controls over the acquisition and contract management processes were not implemented in a way that ensured the Board obtained best value. We found that the acquisition was governed by a contract that provided little cost or performance discipline, was not implemented and administered consistent with the Board's *Acquisition Policy*, and made ineffective use of the General Services Administration (GSA) schedule.

Our outsourcing report contains recommendations to improve statements of work for outsourced contracts and to require a timely legal review of all contracts involving outsourced services. Implementation of these recommendations should address several of the issues we found during our evaluation of this particular acquisition. To address other contract administration issues that surfaced during our evaluation which went beyond the scope of the earlier outsourcing report's recommendations, we provided management two additional recommendations. Specifically, we recommended that the Staff Director for Management strengthen the contract administration process by ensuring that contract modifications and purchase orders authorizing additional work are approved and processed before the work is performed, and by ensuring that all contracts clearly establish the responsibilities and authorities of the contracting officer and contracting officer's technical representative (COTR) in accordance with the Board's *Acquisition Policy*. We also recommended that the Staff Director modify the *Acquisition Policy* to require that exceptions to the use of competitive acquisition methods be approved by the MGT director and to incorporate guidance regarding how to use the GSA Multiple Award Schedule to competitively select vendors for service contracts.

We provided a copy of our report to the MGT director for review and comment. In her response, the director stated she intended to work with Legal to clear up ambiguities in contracts and related documents. The director also plans to review current standard contract language to identify any ambiguities that might cause a vendor to fail to understand the risk incurred by performing work without a contract authorization as well as any ambiguities in the description of the functions and limitations of a COTR. In response to our second recommendation, the director indicated that the Board's *Acquisition Policy* was modified as recommended.

### ***Evaluation of the Fine Arts Program***

During this period, we completed an evaluation of the Board's Fine Arts Program (Program). We performed this evaluation to review the suitability of the Program's current organizational placement within MGT, and assess inventory management practices. The Board's collection includes over 400 works of art, consisting of Board-owned items and pieces on loan from museums, privately owned galleries, and individuals. The Program operates with a budget of about \$420,000 for the two-year period 2004-05, and is staffed by a program director and an administrative assistant. The program director is responsible for collection management, which includes applying "museum standards" for recordkeeping. Because Board funds are not used to purchase works of art, the program director expands the collection by actively soliciting monetary and artwork donations.

We concluded that the Program's current organizational placement in MGT is rational and generally congruent with other organizations that have fine arts

programs. Further, many of the Program's key activities fit with MGT's core functions, such as building services activities, fixed asset management, and accounting for and valuing physical inventory. We noted, however, that the Program could benefit from an enhanced level of supervision and oversight, and suggested that this could be accomplished by placing it either in MGT's General Services section or in their Engineering and Facilities section.

Our review of the Program's inventory management revealed that the program director maintains two separate inventory databases that include different information. Neither of these databases reflected a complete or accurate inventory of the Board's fine arts collection. We worked with the program director to reconcile the two inventory databases, and, once this was completed, we conducted a physical inspection of a judgmentally selected sample that included high-value works of art housed in each of the Board's three buildings. We found each of the items in our sample in the appropriate location.

The difficulty associated with determining the exact count of the Program's current inventory prompted us to conduct additional testing to determine the accuracy of the Board's accounting records. In January 1995, the Board voluntarily adopted a Financial Accounting Standards Board (FASB) provision that allows for recording purchased artwork at cost and donated works of art at fair market value as of the date they are received. Although the amounts involved were not material to the Board's financial statements, we found that the FASB provision was not consistently applied, and that many works of art had not been valued. During the 2003 financial statement audit, the Board determined that it was not required to comply with the FASB provision, and made accounting adjustments to exclude the fine arts collection from the financial statement.

The absence of an accurate inventory management system also prompted us to expand the scope of our review to include a broader based examination of the Program's internal controls. We found that the Program's key functions, such as obtaining monetary contributions, as well as receiving and recording purchased or donated works of art, are all handled and controlled by the program director.

To strengthen the Program's internal controls and to improve overall program operations, we recommended that the director of MGT

- remove the responsibility for receiving works of art and monetary contributions from the program director, and establish written policies and procedures to ensure these duties are handled through the Board's existing processes;
- implement a single fine arts inventory management system;
- institute annual physical inventory counts of the fine arts collection; and

- ensure that all donated works of art are valued by an independent appraiser.

The director and the Board's Committee on Board Affairs agreed with our recommendations except for the independent appraisal which was deemed to not be cost effective given the change in accounting procedures.

### ***Audit of the Board's Information Security Program***

We performed this audit pursuant to requirements in the Federal Information Security Management Act (FISMA), which requires each agency Inspector General (IG) to conduct an annual independent evaluation of the agency's information security program and practices. Our specific audit objectives, based on the legislation's requirements, were to evaluate the effectiveness of security controls and techniques for selected information systems and to evaluate compliance by the Board with FISMA and related information security policies, procedures, standards, and guidelines.

To test security controls and techniques, we reviewed controls over the Board's database application (DB2) and three applications that interface with that software. We also reviewed security settings for selected hardware such as servers, workstations, and routers. Our review of DB2 and our security control tests of the applications did not identify any significant security control deficiencies, although we found several areas where controls need to be strengthened. Our review of security settings also identified additional improvement opportunities related to documentation and the processes for establishing, monitoring, and remediating security settings. Given the sensitivity of the issues involved with these reviews, we provided the specific results to management under separate restricted cover. We also followed up on the status of the recommendations made in our prior control reviews and found that sufficient actions had been taken to close all recommendations.

To evaluate the Board's compliance with FISMA and related policies and procedures, we followed up on the open recommendations in our 2003 information security audit report and reviewed the Board's processes related to security control reviews, certifications and accreditation, remedial action monitoring, incident response, security awareness and training, and patch management. Our follow-up work showed that over the past year the Board has continued to make progress in developing and implementing a structured information security program as outlined by FISMA, and the actions taken are sufficient to allow us to close all of our previous recommendations. We did find, however, that opportunities exist to further enhance the Board's information security program and strengthen compliance with the legislative requirements and related guidance. Our report contains five recommendations designed to improve the Board's procedures related to the plan of action and milestones, security training, security reviews, system inventory, and incident response.

In her response to our draft report, the director of the Division of Information Technology, who serves as the Board's Chief Information Officer for FISMA purposes, concurred with our recommendations regarding enhancements to the Board's plan of action and milestones, security training, and security review procedures. The director agreed with portions of our other two recommendations. The director's response describes actions that have been or will be taken regarding all five recommendations and we will evaluate these actions as part of our continued work related to information security.

In addition to the five recommendations discussed above, our report also discusses several significant challenges for Board management as they begin implementing the new security-related guidance produced by the National Institute of Standards and Technology and the Office of Management and Budget. Based on our review of the guidance issued to date and the draft guidance expected to be finalized over the next year, we believe that the Board will need to fundamentally redesign many of its information security processes to remain consistent with applicable standards. These changes will affect the Board's current processes for risk assessments, control identification and review, as well as certification and accreditation. Because complying with these new requirements will, in our opinion, be essential to maintaining compliance with the security legislation, Board management will need to make the necessary time and resource commitment to ensure that this transition is completed effectively and timely.

### ***Review of the Oversight Function of the Division of Reserve Bank Operations and Payment Systems***

During this period, we completed a review of the Division of Reserve Bank Operations and Payment Systems (RBOPS) oversight function. The review was a high-level scoping effort designed to obtain a better understanding of the current oversight activities and initiatives within RBOPS. Our work focused on thirteen RBOPS program areas which directly provide oversight to the Reserve Banks. For these thirteen program areas, we obtained updated information related to the program area's mission, objectives, and philosophy; upcoming high-level initiatives; core oversight responsibilities and strategies; use of the division's risk assessment model and other analytical tools; and interactions with other internal and external entities. We interviewed RBOPS managers, reviewed policies and procedures governing the RBOPS oversight process, and documented the key RBOPS activities used to carry out its oversight responsibilities. Based on the results of our work, we identified a list of future audit, inspection, and evaluation projects. In addition, the project team presented the results of the review to OIG management and staff to enhance office-wide understanding of the current RBOPS oversight activities.

### ***OIG Application Replacement***

The use of Lotus NOTES as our applications platform has allowed us to automate the majority of our core business processes. However, the original design of most of our key applications was completed in an early release of NOTES, making continued maintenance and support difficult and time consuming. Last year, we completed an assessment of the availability and usability of commercial off-the-shelf software (COTS) for meeting all OIG requirements (audits, evaluations, inspections, investigations, and management information). Based on our assessment, we acquired three COTS packages that we believe will meet our requirements. We completed the initial customization process and began testing the software in our new technology test environment. We also conducted user training on the first of the three products. At the beginning of this reporting period, we implemented the first software package, which is designed to enhance workflow processing for audits, inspections, and evaluations. The application allows us to maximize the use of technology for implementing all related standards and guidance, tracking time and expense charges for each project, and managing staff training and other personnel information. The software will also provide a data repository to enhance information-sharing throughout the office.

### ***Follow-Up on the Audit of the Federal Reserve's Background Investigation Process***

We completed a second follow-up related to our October 2001 *Report on the Audit of the Federal Reserve's Background Investigations Process*. Our audit report contained three recommendations to improve the Board's background investigations program. Our first follow-up concluded that these recommendations should be left open pending final issuance and dissemination of the new suitability policy, which was to include guidance on background investigations. We began our second follow-up based on information received from Board officials indicating that sufficient actions had been taken for us to review the status of our recommendations related to developing guidance on background investigations for contractors and developing policies and procedures on background investigations for summer interns, temporary employees, and transferred employees. Our follow-up work found that there are still areas the Board needs to address to fully implement our recommendations. The new suitability policy has not yet been issued, and no additional guidance has been provided to individuals who are responsible for requesting, conducting, and documenting background investigations. Our testing of files for contractors and temporary employees also identified discrepancies in the issuance of identification badges. Given the results of our testing and the lack of documented guidance, we decided to leave the recommendations open.

### *Follow-Up on the Audit of Retirement Plan Administration*

Our July 2003 *Report of the Audit of Retirement Plan Administration* contained four recommendations describing policy decisions that the Board, either through the Committee on Board Affairs or through its representation on other Systemwide oversight committees, needed to make to strengthen oversight and administration of the retirement plan. Earlier this year, we met with the associate director of the Board's Human Resources Function to discuss actions taken on our recommendations. Based on that meeting and a review of related documentation, we have closed our recommendation regarding the methodology for allocating benefit-related expenses to the Board and Reserve Banks. We will continue to monitor ongoing actions related to our other recommendations.

### *Investigative Activity*

During the reporting period, we opened seven formal investigations and continued work on five cases that were opened during previous reporting periods. Of our twelve active cases, we closed the following four:

- Alleged importation or transportation of obscene materials and the alleged misuse of the Board's automation resources by an employee. We referred this case to the U.S. Attorney's office to determine whether it merited criminal prosecution. The prosecutor declined criminal prosecution of the alleged importation or transportation of obscene materials in favor of available administrative remedies. We referred the alleged misuse of the Board's automation resources to the Board. The disciplinary actions taken by the Board include a five-day suspension without pay, a written reprimand, and a two-year probation period, during which time the employee's Board-assigned computer will be subject to random searches for sexually explicit material. In addition, the employee's annual performance award was reduced substantially.
- Unauthorized travel to Cuba by a Federal Reserve Bank employee. This matter had been referred to us by the U.S. Department of the Treasury, Office of Foreign Assets Control (OFAC) who had received allegations that a Federal Reserve Bank employee had engaged in unlicensed travel-related transactions with Cuba. Our investigation revealed that the employee had traveled to Cuba without authorization on two occasions and we referred this matter to the U.S. Attorney's Office to determine if there was any prosecutive interest in this matter. The U.S. Attorney's Office subsequently declined criminal action and directed us to refer the matter back to OFAC for consideration of a civil money penalty. At this time, further action by OFAC is pending.

- Suspected theft of six nonmonetized Federal Reserve \$50 notes. Non-monetized notes are notes that have not been released to the public and are not in general circulation. It was alleged that the notes had been sent from the Federal Reserve Bank of Richmond to the Board via Federal Express priority mail, but had not arrived at the Board. OIG investigators conducted a joint investigation into this matter with agents of the United States Secret Service. A Board staff member subsequently located the missing notes in a U.S. Postal Service Express mail envelope. The investigation determined that the bills had been mishandled by the Board's remote site mail contactor. The OIG apprised the Board's contracting personnel of the mishandling of mail by the contractor.
- Unauthorized release of procurement information and other contract irregularities. It was alleged that proprietary information was released to a Board vendor that was not released to other potential vendors. Our investigation revealed that the information obtained by the vendor was within the guidelines of the contract and that the vendor received information that was also available to the other potential vendors. Further, no evidence was obtained that revealed that the winning vendor received any preferential treatment that resulted in the award of the contract.

At the end of this reporting period, we had eight active cases. Our summary statistics on investigations are provided in the table that follows:

### Summary Statistics on Investigations for the Period April 1 through September 30, 2004

Investigative Actions	Number
<b>Investigative Caseload</b>	
Investigations Opened during Reporting Period	7
Investigations Open from Previous Period	5
Investigations Closed during Reporting Period	4
Total Investigations Active at End of Reporting Period	8
<b>Investigative Results for this Period</b>	
Referred to Prosecutor	2
Referred for Audit	0
Referred for Administrative Action	1
Oral and/or Written Reprimand	1
Terminations of Employment	0
Suspensions	1
Debarments	0
Indictments	0
Convictions	0
Monetary Recoveries	\$0
Civil Actions (Fines and Restitution)	\$0
Criminal Fines: Fines & Restitution	\$0

## ***Hotline Operations***

Our investigators continue to address allegations of wrongdoing related to the Board's programs and operations, as well as violations of the Board's standards of conduct. During this reporting period, we received 127 complaints, of which eighty-seven were from our hotline operation. Most hotline callers were consumers with complaints or questions about practices of private financial institutions. Those inquiries involved matters such as funds availability, account fees and charges, and accuracy and availability of account records. We continued to receive numerous questions concerning how to process Treasury securities and savings bonds. Other callers contacted us seeking advice about programs and operations of the Board, Federal Reserve Banks, other OIGs, and other financial regulatory agencies. We directed those inquiries to the appropriate Board offices, Reserve Banks, or federal or state agencies. We closed all but eight of the eighty-seven hotline complaints after our initial analysis and contact with the complainants.

In addition to the hotline complaints, the investigative services program received a total of forty allegations; thirty-four were referred to the OIG from Board program staff and six from other sources. As a result of those allegations, the OIG opened three investigations. In addition, we are continuing our review of fictitious instrument fraud complaints. Fictitious instrument fraud schemes are those in which promoters promise very high profits based on fictitious instruments that they claim are issued, endorsed, or authorized by the Federal Reserve System or a well-known financial institution. Our summary statistics of the hotline results are provided in the table that follows:

### **Summary Statistics on Hotline Results for the Period of April 1 through September 30, 2004**

Investigative Actions	Number
<b>Complaints Referred for Investigation</b>	
Hotline Referrals	87
Audit Referrals	0
Referrals from Other Board Offices	34
Referrals from Other Sources	6
<b>Proactive Efforts by OIG</b>	
Investigations Developed by OIG	0
<b>Results of all Complaints Referred and Proactive Efforts</b>	
Resolved	119
Pending	8
<b>Total Received during Reporting Period</b>	<b>127</b>

## *IG Community Participation*

As Vice Chair of the Executive Council on Integrity and Efficiency (ECIE), the Board's IG provides leadership, vision, direction, and initiatives for the ECIE on behalf of the Council Chair (Deputy Director for Management, Office of Management and Budget). Collectively, the members of the ECIE have continued to work with the members of the President's Council on Integrity and Efficiency (PCIE) to help improve Government programs and operations. The Board's IG also serves on the Comptroller General's Advisory Council on *Government Auditing Standards* (Yellow Book), a twenty-member group that works with the General Accountability Office (GAO) to keep the auditing standards current through the issuance of revisions and guidance.

Congressional interest in strengthening IG functionality and independence continued during this semiannual reporting period. As a follow-on to a 2003 hearing which commemorated the twenty-fifth anniversary of the IG Act, the Subcommittee on Government Efficiency and Financial Management, House Committee on Government Reform, invited the Vice Chairs of the PCIE and the ECIE, as well as the Chair of the PCIE's Legislative Committee, to share their views and perspectives on legislation that had been introduced to enhance the IG Act. The July 2004 hearing provided an excellent opportunity to discuss IG roles and responsibilities, as well as present opinions that had the support of a majority of the federal IGs that comprise the two Councils. Going forward, the Subcommittee expressed interest in a continued dialogue on opportunities to further enhance IG functionality and independence.

In addition, as ECIE Vice Chair, the Board's IG once again collaborated with the PCIE Vice Chair in producing *A Progress Report to the President, Fiscal Year 2003*. This annual publication provides a variety of information about the IG community and captures the progress that the PCIE and the ECIE have made toward achieving strategic goals and objectives. Developing this report is a substantial undertaking that involves gathering and consolidating statistical data on thousands of audits, evaluations, and investigations conducted across the federal OIG community, and the 2003 report was particularly important since it commemorated the twenty-fifth anniversary of the IG Act. Under the Vice Chairs' leadership, the report development team further capitalized on automation to substantially simplify and streamline the data collection and consolidation process. The resulting report effectively highlights the collective work and accomplishments of the IGs as a community and focuses attention on the role that the IG community plays in fostering improvement in the numerous challenges facing the federal government today and in the near future.

## *Review of Legislation and Regulations*

As part of fulfilling our mission under the IG Act, we review existing and proposed legislative and regulatory items both as part of our routine activities and on an *ad hoc* basis. We routinely keep track of proposed and pending legislation and regulations by researching relevant documents and databases, reviewing lists prepared by the Board's law library, sharing information with others in the IG community, and coordinating with Board programs that also review new and proposed legislation. We then independently analyze the effect that the new or proposed legislation or regulations may have on the efficiency and effectiveness of the programs and operations of the Board, including the OIG.

During this reporting period, we reviewed numerous bills on a variety of topics. For example, we reviewed H.R. 3457, a bill designed to enhance the operations of the government's IGs. This proposed legislation is similar in many respects to the suggested recommendations arising out of the PCIE/ECIE Legislation Committee project, which we are participating in, to improve the IG Act of 1978. We have been working with staff of the cognizant House committee and subcommittee to reconcile the PCIE/ECIE recommended provisions with the language of H.R. 3457. Among other bills we reviewed were the Law Enforcement Officers Safety Act of 2004, the Data-Mining Reporting Act of 2003, the Department of Homeland Security Financial Accountability Act, and the Missing Child Cold Case Review Act of 2004.

Our review of legislation and regulations also includes commenting on revisions or additions to the Board's management policy statements and internal administrative procedures. For example, we analyzed proposed updates to the Board's "Policy Statement on Firearms and Dangerous Weapons" and provided comments on it that have been adopted. We also reviewed a draft revision of the Board's "Information Security Policy" to ensure its sufficiency.

## Ongoing Projects

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### *Audit of the Board's Automated Travel System*

In late 2003, we initiated an audit of the Board's new automated travel management system. We began the audit based on user concerns that the new system did not meet expectations and was difficult to use. Our objectives were to evaluate the continued viability of the automated system as part of the Board's travel administration process, identify opportunities to improve the efficiency and effectiveness of future system implementations, and follow up on our 1997 *Report on the Business Process Review of Travel Administration*. To accomplish our objectives, we reviewed supporting documentation; interviewed travel project team members, MGT staff, and representatives from ten divisions; and spoke with representatives of other government agencies that use the same automated travel system software. We have issued a draft report to Board management officials for review and comment and plan to issue our final report during the next reporting period.

### *Audit of the Board's Fixed Asset Management Process*

We recently began an audit of the Board's processes for managing its fixed assets. Based on a preliminary analysis of the balances in the fixed asset accounts, we decided to focus our audit work on the accounts for office automation (nonmainframe) computer equipment and office machine/other equipment. Our audit objectives are to evaluate controls over the receipt, recording, and disposal of fixed assets for these two accounts; determine whether amounts recorded in the Board's general ledger are accurate; identify best practices for conducting, tracking, and recording fixed asset inventories; and evaluate the Board's capitalization policy. As part of this audit, we plan to conduct a physical inventory of a sample of the assets recorded in the Board's financial system.

### *Review of the Failure of the Bank of Ephraim*

On June 25, 2004, the Utah Commissioner of Financial Institutions closed The Bank of Ephraim—a \$57 million state member bank headquartered in central Utah. The FDIC estimates that The Bank of Ephraim failure will result in an approximately \$14 million loss to the Bank Insurance Fund. The amount of this loss is below the Federal Deposit Insurance Act threshold that requires the OIG to assess a failed institution's supervision. Nevertheless, we have decided to perform this review because The Bank of Ephraim failure involved fraud, and the loss constitutes a high percentage of the institution's total assets. The objectives of our review are to analyze the Bank's supervision, ascertain why the institution's problems led to failure, and determine if steps can be taken to prevent any such losses in the future. We plan to issue a report on The Bank of Ephraim failure during the next period.

### ***Review of the Board's Worker's Compensation Program***

The Board's employees are covered by the Federal Employees' Compensation Act, which pays workers' compensation benefits to federal civilian government employees for disability due to personal injury or occupational disease sustained while in the performance of duty. We decided to review the Board's worker's compensation program in light of a reorganization that transferred the program from MGT's Support Services function to its Human Resources function, and the potential for dramatic increases in workers' compensation cases now that the Board has hired and trained its own sizable guard force. The objectives of our review are to determine if the Board complies with the requirements established in the Department of Labor's worker's compensation guidance, and to assess the Board's efforts to prevent future worker's compensation cases and encourage timely return to work for employees who have recovered from their injuries. We plan to issue our report during the next period.

### ***OIG Governance Framework***

With our implementation of a new information technology (IT) infrastructure, the OIG initiated a project to develop a governance framework that encompasses the full range of our work; leverages the capabilities of the new technology, in a user-friendly manner; and strengthens and simplifies our policies and procedures. During this reporting period, we designed the governance framework and key policy overview documents, and began redesigning the more detailed policy and procedures to better integrate with the new IT infrastructure and in the context of the governance framework. We anticipate completing this work during the next reporting period.



## **Appendixes**



**Appendix 1**  
**Audit Reports Issued with Questioned Costs for the Period April 1 through**  
**September 30, 2004**

Reports	Number	Dollar Value	
		Questioned Costs	Unsupported
For which no management decision had been made by the commencement of the reporting period	0	\$0	\$0
That were issued during the reporting period	0	\$0	\$0
For which a 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 disallowed	0	\$0	\$0
For which no management decision had been made by the end of the reporting period	0	\$0	\$0
For which no management decision was made within six months of issuance	0	\$0	\$0

**Appendix 2**  
**Audit Reports Issued with Recommendations that Funds be Put to Better Use**  
**for the Period April 1 through September 30, 2004**

Reports	Number	Dollar Value
For which no management decision had been made by the commencement of the reporting period	0	\$0
That were issued during the reporting period	0	\$0
For which a management decision was made during the reporting period	0	\$0
(i) dollar value of recommendations that were agreed to by management	0	\$0
(ii) dollar value of recommendations that were not agreed to by management	0	\$0
For which no management decision had been made by the end of the reporting period	0	\$0
For which no management decision was made within six months of issuance	0	\$0

### Appendix 3 OIG Reports with Outstanding Recommendations

Projects Currently Being Tracked	Issue Date	Recommendations			Status of Recommendations <sup>1</sup>		
		No.	Mgmt. Agrees	Mgmt. Disagrees	Follow-up Completion Date	Closed	Open
Business Process Review of the Board's Travel Administration	07/97	9	9	0	01/99	1	8
Audit of the Board's Efforts to Implement Performance Management Principles Consistent with the Results Act	07/01	4	4	0	08/03	0	4
Audit of the Federal Reserve's Background Investigation Process	10/01	3	3	0	04/04	0	3
Audit of the Federal Reserve Board's Government Travel Card Program	01/02	5	5	0	–	–	–
Audit of the Board's Security-Related Directed Procurements	09/02	3	2	1	–	–	–
Audit of Retirement Plan Administration	07/03	4	3	1	04/04	1	3
Audit of the Board's Information Security Program	09/03	7	7	0	09/04	7	0
Audit of the Board's Outsourcing Operations	04/04	3	3	0	–	–	–
Review of the Fine Arts Program	04/04	2	2	0	–	–	–
Effectiveness of Administrative Controls Over an Outsourced Contract	06/04	2	2	0	–	–	–
Audit of the Board's Information Security Program	09/04	5	5	0	–	–	–

<sup>1</sup> A recommendation is closed if (1) the corrective action has been taken; (2) the recommendation is no longer applicable, or (3) the appropriate oversight committee or administrator has determined, after reviewing the position of the OIG and division management, that no further action by the Board is warranted. A recommendation is open if (1) division management agrees with the recommendation and is in the process of taking corrective action or (2) division management disagrees with the recommendation and we have referred it to the appropriate oversight committee or administrator for a final decision.

## Appendix 4

### Cross-References to the Inspector General Act

Indexed below are the reporting requirements prescribed by the Inspector General Act of 1978, as amended, for the reporting period:

Section	Source	Page(s)
4(a)(2)	Review of legislation and regulations	15
5(a)(1)	Significant problems, abuses, and deficiencies	None
5(a)(2)	Recommendations with respect to significant problems	None
5(a)(3)	Significant recommendations described in previous Semiannual Reports on which corrective action has not been completed	None
5(a)(4)	Matters referred to prosecutory authorities	11
5(a)(5)	Summary of instances where information was refused	None
5(a)(6)	List of audit reports	5-17
5(a)(7)	Summary of significant reports	None
5(a)(8)	Statistical Table—Questioned Costs	21
5(a)(9)	Statistical Table—Recommendations that Funds Be Put to Better Use	22
5(a)(10)	Summary of audit reports issued before the commencement of the reporting period for which no management decision has been made	23
5(a)(11)	Significant revised management decisions made during the reporting period	None
5(a)(12)	Significant management decisions with which the Inspector General is in disagreement	None



*Inspector General Hotline  
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Board of Governors of the Federal Reserve System  
Washington, DC 20551*