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

OFFICE OF INSPECTOR GENERAL

February 26, 1998

The Honorable Eugene A. Ludwig, Chairman
Federal Financial Institutions Examination Council
c/o Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Dear Chairman Ludwig:

The Inspectors General of the Board of Governors of the Federal Reserve System, Department of the Treasury, Federal Deposit Insurance Corporation, and National Credit Union Administration have completed an audit scoping review of the Federal Financial Institutions Examination Council's (FFIEC) operations. As discussed in our January 13, 1998 announcement letter, the objective of this effort was to identify areas that may deserve audit attention and develop an overall strategy for conducting any future audits. Work performed during this scoping effort included the review of laws, legislative history, budgets, annual reports, and prior audits and studies. In addition, we interviewed over forty persons including Council members and staff, participants in each Interagency Task Force and Staff Group, and members of the Appraisal Subcommittee (ASC). We conducted our work in accordance with generally accepted government auditing standards. This letter communicates observations made during the scoping work, offers two recommendations for the Council's consideration, and outlines our plans for future joint audits. We did not solicit comments on our recommendations because these items will be considered at the Council's next quarterly meeting.

We observed that the FFIEC is reasonably successful in fostering coordination among the five federal financial institution regulatory agencies. Council members and heads of the agency's supervision programs were consistent in commenting that the FFIEC's effectiveness, to a large degree, depends on the Chairman's level of commitment.

Recommendation 1: The Appraisal Subcommittee

We recommend that the Council (a) ask its Legal Advisory Group to opine on the legal implications of the ASC's repaying its start-up appropriation and (b) use this opinion as the basis for determining the future administrative, operational, and oversight relationship of the Council and the ASC.

Although the ASC is clearly part of the Council, its enabling legislation makes it somewhat autonomous. Moreover, the exact nature of the relationship between the ASC and the Council for reporting, supervision, and oversight is not spelled out in the legislation and has not been specifically

defined by either organization. As an appropriated entity, the ASC is subject to the statutes and regulations that govern the expenditure of appropriated funds. In contrast, the agencies comprising the FFIEC are non-appropriated entities. Accordingly, avoiding the commingling of appropriated and non-appropriated funds has created some administrative inefficiencies. For example, ASC officers and staff are all permanent employees of the ASC, subject to Title 5 of the U.S. Code, while the Council's staff and officers are not subject to Title 5 because they are detailed from the five federal financial institution regulatory agencies and follow their home agency's personnel and compensation policies. Also, the ASC contracts with the General Services Administration for administrative support, while the Council contracts with the Board of Governors of the Federal Reserve System for its administrative support. Moreover, each entity maintains its own computer system and uses separate staff for legal support.

In 1996, 12 U.S.C. § 3337 was amended to require the ASC to repay the balance of its $5 million start-up appropriation no later than September 30, 1998. In our view, the forthcoming start-up appropriation repayment creates a window of opportunity for addressing the lack of clarity in the relationship between the Council and ASC as well as related administrative inefficiencies. We believe a prudent first step in this process would be to determine whether the repayment affects the ASC's status as an appropriated agency. If, for example, it is determined that the ASC can be regarded as a non-appropriated entity, one of the Council's options would be to carry out the ASC's functions directly by structuring it to operate and report like the existing task forces**.** On the other hand, a determination that the repayment does not affect the ASC's appropriated status would likely result in little structural change because measures to avoid commingling of appropriated and non-appropriated funds would still be required.

Recommendation 2: State Liaison Committee

We recommend that the Council invite SLC members to participate as nonvoting members on Task Forces that address supervisory issues affecting the states.

Public Law 95-630 authorized the establishment of the State Liaison Committee (SLC) to encourage application of uniform examination principles and standards by state and federal agencies. The SLC consists of five representatives of state agencies that supervise financial institutions. The SLC carries out its responsibilities by assuming an active advisory role in all Council deliberations, and the FFIEC provides staff support through the Assistant Executive Secretary. SLC members we interviewed believe they have ample opportunity to provide input on issues that come before the Council and are pleased that they are free to place items on the FFIEC's agenda. However, we observed that with the exception of the newly created Task Force on Information Sharing, the SLC is not represented on FFIEC Task Forces where most of the actual staff work is performed. We believe that SLC participation on Task Forces that address issues affecting the states could enhance coordination and communication among state and federal regulators.

Future Audit Work

We have identified three specific joint audits that we plan to conduct over the next 36 months.

First, we plan to begin work on an *Audit of the FFIEC's Training Function* in the spring of 1998. This topic was chosen because the Council's training activities are specifically mandated in the FFIEC enabling legislation, and the training function has never been the specific focus of any prior IG audit. Our objectives shall be to determine whether the

— goals of the FFIEC training program are being met,
— Examiner Education Task Force is an efficient and effective vehicle for guiding the FFIEC training program, and
— current budget process adequately serves the objectives and goals of the FFIEC training program.

Second, we plan to conduct an *Operations Review of the ASC* in early 1999. The timing of this review will provide the Council with sufficient time to consider our recommendation and implement any changes to the relationship with the ASC. In addition, we believe attention is warranted because the ASC has not had an independent review beyond the annual audit of its financial statements. The objectives of the operations review shall be to

— determine whether the ASC is meeting its objectives and to review overall program effectiveness,
— assess the efficiency and effectiveness of ASC operations, and
— assess the adequacy of internal administrative controls as well as grant administration.

Third, we plan to conduct an *Operations Review of the FFIEC* in the fall of 1999. This review will be performed at an opportune time because the successor to the current FFIEC Executive Secretary will have been in place for over a year and it will have been six years since the last Inspector General audit of the FFIEC. The objectives of the FFIEC operations review shall include

— taking a fresh look at the Council's effectiveness in coordinating regulatory issues and fostering its legislative mandates and goals,

— assessing the efficiency and effectiveness of the Council's administrative operations and internal controls,
— evaluating the effectiveness of the Council's Task Force structure, and
— assessing the effectiveness of communication between the Council and the task forces.

Should you have any questions about our recommendations or plans for future work, please feel free to contact any of us.

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cc: Governor Susan M. Phillips, Board of Governors of the Federal Reserve System
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