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

FOR RELEASE ON DELIVERY
Expected at
10 a.m. October 2, 1973

STATEMENT OF
ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES
BEFORE THE
COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES
ON

HSE 00700

[H.R. 10265,] A BILL TO PROVIDE FOR AN AUDIT OF THE
FEDERAL RESERVE SYSTEM BY THE GENERAL ACCOUNTING
OFFICE AND FOR OTHER PURPOSES

We welcome the opportunity to testify before this committee concerning the proposal in H.R. 10265 to require our Office to make annual audits of the Federal Reserve Board, banks and branches. We have no comments on the other provisions of the bill.

Before I comment on some of the specific points I would like to make concerning the provisions of H.R. 10265, I believe it would be advisable to briefly discuss some of the background on prior proposals to require our Office to audit the Federal Reserve System.

Until 1933, GAO audited the expenditure vouchers of the Federal Reserve Board but not of the banks. The audits were made because of the ruling of the Attorney General in 1914 that the funds obtained by

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assessment by the Board from the banks to meet the expenses were public moneys. The Banking Act of 1933, however, superseded this ruling by declaring that these funds were not to be construed as Government funds or appropriated moneys. With this change, the GAO audit of the Board's expenditure vouchers was discontinued.

As you are aware, Mr. Chairman, on occasion our Office has assisted this Committee in its work relating to the Federal Reserve System. In 1971, we also completed at your request as Chairman of the Joint Economic Committee a study of the reporting system operated by the Federal Reserve Bank of New York for dealers in Government securities.

With one exception, however, we do not have the authority to initiate audits of the several entities of the Federal Reserve System. The exception is the responsibility assigned to us by the act of May 20, 1966, to audit the cancellation and destruction of United States currency unfit for circulation. Specifically, this act provides that:

"The Comptroller General of the United States shall audit the cancellation and destruction, and the accounting with respect to such cancellation and destruction, of any currency of the United States unfit for circulation, regardless of who is responsible for, and regardless of who performs, such cancellation, destruction, or accounting. The Comptroller General shall have access to any books, documents, papers, and records which he deems necessary to facilitate an effective audit pursuant to this section."

This audit authority was provided in connection with the change in procedures to transfer authority to destroy unfit Federal reserve notes, previously vested by law in the Comptroller of the Currency, to the Secretary of the Treasury. The destruction of most unfit currency is carried out in Federal Reserve banks. We have since reviewed these activities of the Federal Reserve banks on a selected basis each year. Three reports on this work have been submitted to this Committee. In addition, 20 reports have been submitted to the presidents of the specific Reserve banks.

Generally, we have not found significant deficiencies in the administrative procedures and controls over these activities.

The question of whether there should be a GAO audit of the Federal Reserve Board and the Reserve banks was discussed during consideration of the legislation which resulted in the Government Corporation Control Act of 1945. The primary purpose of this act was to provide greater congressional control over wholly-owned and partly-owned Federal corporations. It was determined that the Federal Reserve Board and banks should be excluded from the audit provisions of that act. Apparently, the main reasons for this determination was that the Board exercised strong control over the Reserve banks and all of the stock of those banks was owned by member banks rather than by the Government.

A bill introduced on July 20, 1959, in the 86th Congress, H.R. 8302, would have directed the Comptroller General to conduct an audit of the Federal Reserve System for the period commencing with the enactment of the Federal Reserve Act, December 23, 1913, and ending December 31, 1958. We objected to this measure because it would have required an audit for a 45-year period which, as we then stated, constituted "a tremendous task which would drain our audit manpower assigned to defense and other important Government expenditures."

In subsequent years other bills have been introduced, but not enacted, which would have required GAO to audit the Federal Reserve System. In commenting on such legislation we offered no opinion on whether such an audit by our Office was advisable, but stated that if the Congress wanted such an audit made, we would carry out the congressional intent by making whatever audits the Congress wished.

One of the primary purposes of the Federal Reserve System is the control and regulation of the supply of money and credit. The Federal Reserve System expands and contracts the supply of money and credit primarily by purchasing and selling U.S. Government obligations. As of June 30, 1973, the Federal Reserve System owned U.S. securities totaling about \$75 billion. The financial statements of the Federal Reserve banks

for calendar year 1972 show that total earnings from operations amounted to about \$3.8 billion of which about 99 percent was derived from interest on U.S. Government securities. Total expenses of the banks in 1972 amounted to about \$442 million including about \$35 million in assessments for the expenses and other costs of the Board of Governors; non-operating losses amounted to about \$49 million; member banks were paid dividends of about \$46 million; and about \$51 million was transferred to surplus. The balance of net earnings, amounting to about \$3.2 billion, was transferred to the U.S. Treasury.

In view of the highly important part the Federal Reserve System plays in the Nation's system of money and credit, we have concluded that there should be a GAO audit of the Federal Reserve Board and the Reserve banks. However, there are three possible alternatives that may be considered in determining the scope of the audits in the event Congress agrees with our view as to the need for a GAO audit.

1. The first alternative would be an audit of the accounts, financial transactions, and financial reports of the Board, and the Reserve banks. This kind of audit would be for the purpose of arriving at opinions as to whether financial transactions are carried out in accordance with applicable legal requirements and are properly accounted for, and whether the financial reports present fairly the financial position, changes in financial position, and results of operations of the various entities in the System. As provided in

H.R. 10265, our reports on such work would disclose any program, financial transaction, or undertaking which in our opinion was carried on without authority of law. In performing this kind of an audit, we would first make a careful review of the nature and adequacy of all audit work already being performed within the Federal Reserve System under existing arrangements before determining how much additional auditing by us would be needed.

2. The second alternative would embrace the audit work included in the first alternative but would be extended to include selected examination of the management of resources (such as computers and other equipment, buildings, and personnel) to evaluate the efficiency and economy with which such resources are procured and used. Such audit work would include determining the causes of any inefficient or uneconomical practices found and proposing constructive recommendations for improvement for the consideration of management officials. H.R. 10265 specifically provides for audit work of this nature since it requires that we include in our reports "recommendations for attaining a more economical and efficient administration of the entities audited."
3. The third alternative would embrace the kind of audit work described for the first two alternatives but would be further extended to include reviews of the results of the programs and activities of the System, including the extent to which its established objectives are being achieved. This extension of the scope of our auditing activities was specifically directed in the Legislative Reorganization Act of 1970

with respect to Federal Departments and agencies. That act directs us to "review and analyze the results of Government programs and activities carried on under existing law." As we interpret H.R. 10265, the language is broad enough to embrace this alternative.

The language in section 1(a) of the bill refers to the Federal Reserve Board and the Federal Reserve banks and their branches. The Federal Advisory Council and the Federal Open Market Committee are part of the Federal Reserve System but technically are not a part of the Board of Governors or the Federal Reserve banks and H.R. 10265 would authorize our Office to audit only the Board of Governors and the Federal Reserve banks and branches. If the Board of Governors and the Federal Reserve banks and branches are to be audited by our Office, we believe that the Federal Advisory Council and the Federal Open Market Committee should also be subject to audit by our Office.

Section 1(b) of H.R. 10265 states that GAO shall have access to reports of examinations of member banks. We have assumed that this language would give us access to examination reports of member banks in the custody of the Board or the Reserve banks prepared by bank examiners of the Comptroller of the Currency, the FDIC, and the various States as well as those of the Federal Reserve banks. We are not therefore suggesting any change in the language of H.R. 10265 in this regard. We do suggest, however, that the Committee report on the bill make it clear that GAO will be given access to all examination reports, from whatever source, of member banks.

H.R. 10265 calls for an annual audit and also an annual report. We do have reservations about this requirement. The Federal Reserve System is a large organization and its operations are complex. The additional workload this requirement would thrust on us would be heavy. We would much prefer that the annual audit requirement be removed and that the activities of the Federal Reserve System, if it is to be audited by GAO, be placed on the same basis as those of the Federal departments and agencies so far as frequency of audit is concerned. Under the Budget and Accounting Act, 1921, and the Budget and Accounting Procedures Act of 1950, the determination as to frequency as well as scope of audit performed is left to our judgment. These judgments are made in the light of congressional interest in specific programs and problems and, as the 1950 act 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."

The audit language in the bill provides that the GAO audit be made under such rules and regulations as we prescribe. In accordance with our regular audit policy, any rules or regulations that we would prescribe would specifically require our auditors to review and evaluate the nature and effectiveness of any auditing already being done in the System in determining the extent of GAO audit work to be performed. 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 our mentioning this point is that we recognize that a substantial amount of auditing is already being performed in the System. Under existing arrangements, a firm of independent CPAs makes an annual audit of the accounts of the Board of Governors and their opinion on the Board's financial statements is included in the Board's annual report. We understand that copies are furnished to this Committee and to the Senate Committee on Banking, Housing and Urban Affairs.

We also understand that each Federal Reserve Bank and branch is examined at least once each year by the Board's staff of field examiners, who are directed by the Board to determine the financial condition of the Bank and compliance by its management with applicable provisions of law and regulation. The examination includes a comprehensive review of each Bank's expenditures to determine if they are properly controlled and of a nature appropriate for a Reserve Bank. A public accounting firm is engaged to accompany the Board's examiners on their examination of one Reserve bank each year, to provide an outside evaluation of the adequacy and effectiveness of the examination procedures.

The operations of each bank are also audited by an internal auditing staff on a year-round basis. This work is done under the direction of a resident general auditor who is responsible to the bank's board of directors through its chairman and its audit committee. The Board's examiners review the internal audit programs of each bank each year to see whether the coverage is adequate and the procedures effective.

In view of the substantial amount of auditing already being performed in the System, we believe that a requirement for an annual audit by our Office could result in an uneconomical use of our staff. If the audit language could be written to give us more flexibility as to the frequency of audit, I am sure that we could provide the Congress with relatively frequent GAO reports on the financial operations of the System and on any problems of specific interest or concern to the Congress made known to us.

The audit language in H.R. 10265 is broad in that it would direct us to make an audit of the Board and the Reserve banks and their branches for each fiscal year and no restriction of any kind is stated. Coupled with the provision that the Comptroller General shall prescribe rules and regulations for the audits, the language of the bill as drafted would give us the option of determining the nature and extent of audit work to be done. If it is intended that the GAO audit embrace all of the alternatives I described earlier and that such audit include the Federal Advisory Council and the Federal Open Market Committee, there is attached draft language, as a substitute for H.R. 10265, which we believe more specifically sets out the type of authority we need.

This concludes my statement, Mr. Chairman.

SUGGESTED ALTERNATIVE LANGUAGE

SEC. 1. (a) The Comptroller General is authorized and directed to audit the programs, activities, and financial operations of the Federal Reserve System (including the Board of Governors of the Federal Reserve System, the Federal Reserve banks, branch banks, the Federal Advisory Council, and the Federal Open Market Committee) and to make recommendations for achieving greater efficiency, economy, and effectiveness in the conduct of such programs, activities, and financial operations. The audits shall be made under such rules and regulations as may be prescribed by the Comptroller General. A report of any such audit shall be made by the Comptroller General to the Congress when he deems it necessary to keep the Congress informed of the programs, activities, and financial operations of the System, together with such recommendations with respect thereto as the Comptroller General may deem advisable.

(b) In making the audit required by subsection (a), representatives of the General Accounting Office shall have access to books, accounts, records, reports, files, and all other papers, things, or property belonging to or used by the entities being audited, including reports of examinations of member banks, and they shall be afforded full facilities for verifying transactions with balances or securities held by depositaries, fiscal agents, and custodians of such entities.

(c) The Comptroller General is authorized to employ such personnel and to obtain such temporary and intermittent services as may be necessary to carry out the audit required by subsection (a), at such rates as he may determine, without regard to the civil service and classification laws, and without regard to section 15 of the Act of August 2, 1948, as amended (5 U.S.C. 3109b).

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assessment by the Board from the banks to meet the expenses were public moneys. The Banking Act of 1933, however, superseded this ruling by declaring that these funds were not to be construed as Government funds or appropriated moneys. With this change, the GAO audit of the Board's expenditure vouchers was discontinued.

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(b) In making the audit required by subsection (a), representatives of the General Accounting Office shall have access to books, accounts, records, reports, files, and all other papers, things, or property belonging to or used by the entities being audited, including reports of examinations of member banks, and they shall be afforded full facilities for verifying transactions with balances or securities held by depositaries, fiscal agents, and custodians of such entities.

(c) The Comptroller General is authorized to employ such personnel and to obtain such temporary and intermittent services as may be necessary to carry out the audit required by subsection (a), at such rates as he may determine, without regard to the civil service and classification laws, and without regard to section 15 of the Act of August 2, 1948, as amended (5 U.S.C. 3109b).