

GAO

Testimony



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Federal Reserve: Views on Proposed Expanded
Access Authority for GAO

Statement of
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Before the
Subcommittee on Domestic Monetary Policy
Committee on Banking, Finance and Urban Affairs
House of Representatives



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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here to discuss section 5 of H.R. 3512 which would expand the General Accounting Office's authority in connection with audits of the Federal Reserve System.

In keeping with the Subcommittee's request, I will cover the nature of GAO's audit activities; the ways in which we have utilized our existing authority under the Federal Banking Agency Audit Act of 1978 in auditing Federal Reserve System activities; and an analysis of the new authority that would be granted by Section 5 together with the practical consequences associated with exercising that authority.

NATURE OF GAO AUDIT ACTIVITIES

Our audit work is not easily categorized. Our audits deal with the financial reporting of government activity, the efficiency of program implementation, and the evaluation of program results. The range of topics includes:

- audits designed to assess the validity of financial reports covering entire entities and audits of financial data related to specific segments of larger entities;

- audits designed to assess the efficiency with which entire programs are administered and audits of how particular

organizational elements carry out their administrative responsibilities; and

-- audits directed toward evaluating how well government programs are meeting their objectives in the broadest context and audits of how well those purposes are being served in relation to issues more limited in programmatic and geographic scope.

Table 1, attached, spells out in more detail the kinds of issues we cover in our various audits.

Most of our audits are done pursuant to specific legislative mandate or pursuant to requests for assistance from congressional committee chairs. We also undertake audit and evaluation work on our own initiative. Although we work independently, it is our policy to keep the Congress and agencies apprised of the nature and scope of our work. Provisions of title 31 of the United States Code, covering GAO authorities generally, make clear that in the absence of any special legislative provisions we have unrestricted access to all government agency books and records we deem necessary to do our work.

Our audit authority over certain agencies, such as the Internal Revenue Service, is covered by specific legislation, as is our authority in connection with the Federal Reserve System.

GAO AUTHORITY UNDER THE BANKING AGENCY AUDIT ACT
AND WORK AT THE FEDERAL RESERVE

The Federal Banking Agency Audit Act (the Act) was passed in 1978 following a special congressionally mandated GAO study of the supervisory activities of all of the federal bank regulatory agencies.

This study, which commenced in 1976, was conducted because of congressional concern over large bank failures and lengthening problem bank lists. In light of the heavy congressional interest in the study, the banking agencies (the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation) agreed to give us unlimited access to their bank examination reports and other related records, provided we would not disclose any information about specific banks, bank officers, or bank customers. Our report contained several recommendations concerning the examination and supervision of banks and bank holding companies. The report also pointed out that we could be more helpful to Congress as it carried out its legislative and oversight responsibilities for bank insurance and regulation if Congress provided for GAO audits of banking agency programs.

Except for this special study, GAO had not examined regulatory aspects of the banking system prior to passage of the Act. GAO's work at the Federal Reserve was limited mainly to audits of

fiscal agent functions performed by Federal Reserve banks for the Treasury, and we did this work pursuant to our authority to audit the Treasury Department. While the Act significantly expanded GAO's access to the Federal Reserve System and the other bank regulatory agencies, it precluded GAO from access to matters related to the Federal Reserve System's foreign transactions, monetary policy, and Federal Open Market Committee (FOMC) operations. See Table 2, attached. The Act also included provisions that prohibit us from disclosing information identifying institutions or customers and that require safekeeping of records. See Table 3, attached.

Our work at the Federal Reserve has covered many topics. Over the past decade, we have reviewed the Federal Reserve's

- internal audit arrangements;

- supervision of banks and bank holding companies, including procedures for assessing risks posed by loans to foreign countries and for supervising the overseas activities of bank holding companies;

- regulation of foreign owned banks operating in the United States;

- implementation of provisions for pricing check clearing and other services provided to depository institutions under the Monetary Control Act of 1980;
- surveillance of primary dealers in the government securities market;
- activities under bank secrecy laws;
- administrative expenses;
- key electronic systems including Fedwire and the securities transfer system; and
- consumer protection activities.

Our current and planned work includes analyses of (1) bank holding company subsidiaries authorized by the Federal Reserve to underwrite and deal to a limited extent in non-government securities (the so called section 20 subsidiaries), (2) the quality of the Federal Reserve's oversight and supervision of bank holding companies and state chartered member banks, (3) implementation of the Government Securities Act of 1986, (4) implementation of the Expedited Funds Availability Act; and (5) implementation of the new risk-based capital standards for banks in this country and abroad.

The work we have done has contributed to changes in both Federal Reserve practices and legislation. In general, we have had no significant problems in obtaining necessary cooperation from the Federal Reserve System, and we coordinate our activities with the Federal Reserve's Inspector General's Office.

Access questions

There have been a few times when the statutory limits to our rights of access were an issue in work we were asked to do -- (1) a 1982 study of the effects of monetary policy on housing and other parts of the economy, (2) a 1984 investigation of a leak of information regarding FOMC deliberations, and (3) a 1983 and 1984 examination of the Federal Reserve Bank of New York's System for accounting for Treasury Securities, a study that included accounting for Federal Reserve transactions conducted with, or on behalf of, foreign entities.

In each of these cases we found a reasonable way to satisfy our requirements. In the first case, we used information in the public domain and from sources outside of the Federal Reserve. In the second, we worked out arrangements for interviewing all persons in the Federal Reserve System with access to FOMC data. In the third, we worked out a method for testing transactions that blocked out the names of any foreign governments or international institutions that were involved.

IMPLICATIONS OF SECTION 5

Section 5 of H.R. 3512 would remove the constraints on GAO's access concerning monetary policy and FOMC deliberations. The only remaining restrictions would be those related to foreign transactions. See Table 4, attached. The proposed legislation appropriately continues to allow the type and frequency of audit work to be determined by congressional requests and our own discretion.

The enactment of Section 5 would facilitate our ability to audit the financial transactions of Federal Reserve banks. Over 80% of the almost \$300 billion in assets on the combined balance sheets of the Federal Reserve banks are securities and discount loans acquired as a result of transactions associated with monetary policy activities. These transactions are, however, examined by the Board of Governors through its Division of Federal Reserve Bank Operations. Each year the Board examines the Federal Reserve banks under what it calls its Financial Examination Program. The Board devotes about 20 staff years to this activity, at an annual cost of about \$1.5 to \$2.0 million.

The Board's Financial Examination Program was recently reviewed by Price Waterhouse, the accounting firm which at the time was under contract to the Board of Governors to review the Board's own operations and to advise on audits of the individual reserve

banks. Price Waterhouse concluded that the program was operating effectively; that the examinations were being conducted in accordance with generally accepted auditing standards, as applicable within the scope of the examinations; and that the scope of work conducted by the program was adequate to conclude that the Federal Reserve banks were being operated in a safe and sound manner.¹

Section 5 of H.R. 3512 would continue to prohibit GAO's access to international transactions. This restriction is based largely on the sensitivity of many foreign governments in regard to their dealings with the Federal Reserve System and on the non-public nature of much of the information involved. As is the case with monetary policy restrictions, this restriction potentially inhibits our ability to conduct certain financial or program audits that might help Congress in its oversight of the Federal Reserve. If Congress is inclined toward enacting the provisions of Section 5, we think consideration should also be given to removing the restriction on our access to international activities with appropriate limitations on the disclosure of specified information.

The case for adopting Section 5 depends principally on the extent to which Congress wants GAO to be able to audit monetary policy

¹Price Waterhouse, Board of Governors of the Federal Reserve System: Operational Review of the Division of Bank Operations, 1988 Review of Financial Examination Program, March 10, 1989.

activities. Given the key role that the Federal Reserve plays in financial markets, GAO access to the FOMC and monetary policy deliberations would provide for additional assistance to the Congress in its oversight of Federal Reserve System activities. We, therefore, stand ready to accept the responsibilities that Section 5 would assign to us, if enacted. Some cautions are in order, however.

SAFEGUARDS THAT SHOULD ACCOMPANY
ANY EXPANSION OF GAO'S AUDIT AUTHORITY

If GAO's audit authority in the monetary policy area were to be extended, there are several additional safeguards that should be included in the legislation to protect the independence of the Federal Reserve from undue interference. These safeguards should include provisions:

(1) To prevent disclosure of confidential documents or information to the Congress or to third parties, and to require the safekeeping of confidential information. As noted in Table 3, the Act already contains some safeguards along these lines. Additional safeguards should be established to take account of the sensitive nature of certain monetary policy information.

(2) To delay access for a definite period to information the Federal Reserve considers confidential. Some Federal Reserve

decisions must be made quickly in crisis situations such as occurred when stock prices fell precipitously in October, 1987. The independence of the Federal Reserve would be preserved by making clear that GAO could not be asked to look over the shoulders of Federal Reserve officials as policies were being made. Our role should be to make after-the-fact assessments of the structural strengths and weaknesses in the Federal Reserve's ability to deal with problem situations rather than to critique specific decisions.

SUMMARY

In summary, we have been able to do significant audits of the Federal Reserve under our existing authority. Congress obviously must make the judgement as to whether our audit authority should be expanded. However, if GAO authority is to be expanded, we think measures should be included to protect against unwarranted disclosure of information and undue interference with the Federal Reserve's policy decision functions.

This concludes my prepared statement. My colleagues and I would be pleased to answer questions.

TABLE 1:

TYPES OF GAO AUDITS

FINANCIAL AUDITS

1. Financial statement audits determine (a) whether the financial statements of an audited entity present fairly the financial position, results of operations, and cash flow or changes in financial position in accordance with generally accepted accounting principles, and (b) whether the entity has complied with laws and regulations for those transactions and events that may have a material effect on the financial statements.
2. Other financial audits include determining (a) whether financial reports and related items, such as elements, accounts, for funds are fairly presented, (b) whether financial information is presented in accordance with established or stated criteria, and (c) whether the entity has adhered to specific financial compliance requirements.
3. Financial audits include an assessment of internal control risks related to the scope of the audits.

PERFORMANCE AUDITS

1. Economy and efficiency audits include determining (a) whether the entity is acquiring, protecting, and using its resources (such as personnel, property, and space) economically and efficiently, (b) the causes of inefficiencies or uneconomical practices, and (c) whether the entity has complied with laws and regulations concerning matters of economy and efficiency.
2. Program audits include determining (a) the extent to which the desired results or benefits established by the legislature or other authorizing body are being achieved, (b) the effectiveness of organizations, programs, activities, or functions, and (c) whether the entity has complied with laws and regulations applicable to the program.

Source: U.S. General Accounting Office Government Auditing Standards, 1988 revision.

TABLE 2:

RESTRICTIONS ON GAO AUDITS CONTAINED IN
THE FEDERAL BANKING AGENCY AUDIT ACT.1/

Audits of the Federal Reserve Board and Federal Reserve banks may not include

- (1) transactions for or with a foreign central bank, government of a foreign country, or nonprivate international financing organization;
- (2) deliberations, decisions, or actions on monetary policy matters, including discount window operations, reserves of member banks, securities credit, interest on deposits, and open market operations;
- (3) transactions made under the direction of the Federal Open Market Committee; or
- (4) a part of a discussion or communication among or between members of the Board of Governors and officers and employees of the Federal Reserve System related to items (1), (2), or (3).

1 31 U.S.C. section 714(b). This codifies a portion of section 2 of Public Law 95-320, July 21, 1978, which amended section 117 of the Accounting and Auditing Act of 1950.

TABLE 3:

PROVISIONS IN THE FEDERAL BANKING AGENCY
AUDIT ACT CONCERNING DISCLOSURE OF INFORMATION
AND SAFEKEEPING OF RECORDS.^{1/}

- (1) An officer or employee of the General Accounting Office may not disclose information identifying an open bank, an open bank holding company, or a customer of an open or closed bank or bank holding company.
- (2) Except for the temporary removal of workpapers of the Comptroller General that do not identify a customer of an open or closed bank or bank holding company, an open bank, or an open bank holding company, all workpapers of the Comptroller General and records and property of or used by an agency that the Comptroller General possesses during an audit, shall remain in the agency. The Comptroller General shall prevent unauthorized access to records or property.

¹Excerpts from 31 U.S.C. section 714 (c), (d).

TABLE 4:

RESTRICTIONS ON GAO AUDITS THAT WOULD REMAIN
UNDER SECTION 5 OF H.R. 3512

Audits of the Federal Reserve Board and Federal Reserve banks
could not include

- (1) transactions for or with a foreign central bank,
government of a foreign country, or nonprivate
international financing organization; and
- (2) memoranda, letters, or other written communications
between or among members of the Board of Governors of the
Federal Reserve System or officers or employees of the
Federal Reserve System relating to any transaction
described in paragraph (1).