



OFFICE OF INSPECTOR GENERAL

Audit Report

2013-AE-B-013

The Board Can Benefit from
Implementing an Agency-Wide Process for
Maintaining and Monitoring
Administrative Internal Control

September 5, 2013

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
CONSUMER FINANCIAL PROTECTION BUREAU

Report Contributors

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Abbreviations

Board	Board of Governors of the Federal Reserve System
COSO	Committee of Sponsoring Organizations of the Treadway Commission
FMFIA	Federal Managers' Financial Integrity Act of 1982
GAO	Government Accountability Office
OIG	Office of Inspector General
OMB	Office of Management and Budget



Executive Summary:

The Board Can Benefit from Implementing an Agency-Wide Process for Maintaining and Monitoring Administrative Internal Control

2013-AE-B-013

September 5, 2013

Purpose

Our objective for this audit was to determine the processes for establishing, maintaining, and monitoring internal control within the Board of Governors of the Federal Reserve System (Board). We focused on internal control over the effectiveness and efficiency of operations and compliance with laws and regulations, i.e., administrative internal control. Our scope does not include internal control over financial reporting or information systems because the Board issues a management assertion on internal control over financial reporting and complies with the Federal Information Security Management Act of 2002, which requires agencies to establish and maintain an information security program to protect information and information systems.

Background

Internal control is an integral part of managing an organization and is critical to improving organizational effectiveness and accountability. It comprises the plans, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal control is the first line of defense in safeguarding assets and preventing and detecting errors and fraud and, thus, helps organizations achieve desired results through effective stewardship of public resources.

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) requires that each executive agency establish internal accounting and administrative controls in compliance with standards established by the Government Accountability Office and prepare an annual statement on internal control based on an evaluation performed using Office of Management and Budget guidelines. Although the Board is not subject to FMFIA, the Board decided to voluntarily comply with the spirit and intent of FMFIA shortly after its enactment. The Board's approach to FMFIA remains unchanged.

Findings

We found that the Board's divisions have processes for establishing administrative internal control that are tailored to their specific responsibilities. These controls generally utilize best practices and are designed to increase efficiency and react to changing environments. The Board's processes for maintaining and monitoring these controls can be enhanced. Specifically, we found that the Board does not have an agency-wide process for maintaining and monitoring its administrative internal control.

Although the Board is not subject to FMFIA, the Board decided to voluntarily comply with the spirit and intent of FMFIA. The Board's approach to addressing the provisions of FMFIA does not require management to assess and monitor administrative internal control. We believe that an agency-wide process that maintains, monitors, and reports on administrative internal control can assist the Board in effectively and efficiently achieving its mission, goals, and objectives, as well as address the organizational challenges outlined in the Board's 2012–2015 strategic framework.

Recommendation

We recommend that the Chief Operating Officer (COO) designate responsible officials or an office to develop and implement an agency-wide policy and process to more closely follow the spirit and intent of FMFIA and develop a training program to increase staff awareness about maintaining and monitoring administrative internal control.

In its response to a draft of our report, the COO stated that the Board concurred with the recommendation's intent. The COO also stated that the Board has already implemented, or is in the process of implementing, several enhanced administrative processes. He added that, given the priorities and budgetary constraints underlying the Board's new strategic framework, Board management will evaluate whether, and in what form, an agency-wide framework makes sense and will coordinate with the Executive Committee of the Board to implement any additional requirements.

Access the full report: http://www.federalreserve.gov/oig/files/FRB_Administrative_Internal_Control_full_Sep2013.pdf
For more information, contact the OIG at 202-973-5000 or visit <http://www.federalreserve.gov/oig>.

Summary of Recommendation, OIG Report No. 2013-AE-B-013

Rec. no.	Report page no.	Recommendation	Responsible office
1	10	Designate responsible officials or an office to <ul style="list-style-type: none"><li data-bbox="623 310 1062 415">a. develop and implement an agency-wide policy and process to more closely follow the spirit and intent of the Federal Managers' Financial Integrity Act of 1982.<li data-bbox="623 436 1062 512">b. develop a training program to increase staff awareness about maintaining and monitoring administrative internal control.	Chief Operating Officer



OFFICE OF INSPECTOR GENERAL
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
CONSUMER FINANCIAL PROTECTION BUREAU

September 5, 2013

MEMORANDUM

TO: Donald Hammond
Chief Operating Officer
Board of Governors of the Federal Reserve System

FROM: Melissa Heist *Melissa Heist*
Associate Inspector General for Audits and Evaluations

SUBJECT: OIG Report No. 2013-AE-B-013: *The Board Can Benefit from Implementing an Agency-Wide Process for Maintaining and Monitoring Administrative Internal Control*

Attached is the Office of Inspector General's (OIG's) final report on the subject audit. We conducted this audit to determine the processes for establishing, maintaining, and monitoring internal control within the Board of Governors of the Federal Reserve System (Board). We focused on internal control over the effectiveness and efficiency of operations and compliance with laws and regulations, i.e., administrative internal control.

We provided you with a copy of our draft report for review and comment. In your response, you stated that you concurred with the intent of our recommendation, and that you planned to evaluate whether, and in what form, an agency-wide framework makes sense and that you will coordinate with the Executive Committee of the Board to implement any additional requirements. The Inspector General Act, as amended, requires that we report in our Semiannual Report to Congress on recommendations for which no management decision has been made. The act defines a management decision as the issuance of a final decision by management concerning its response to audit findings and recommendations, including actions concluded to be necessary. Since your response indicates that you have not yet determined the final actions you will take to address our report's findings we request that you provide to us within 90 calendar days a final management decision describing the actions you have taken or that you plan to take to address our recommendation. We have included your response as appendix B to our report.

We appreciate the cooperation that we received from the Board's Office of the Chief Operating Officer and the divisions with which we met. Please contact Cynthia Gray, Senior OIG Manager, or me if you would like to discuss this report or any related issues.

Attachment

cc: Michelle A. Smith, Office of Board Members
Michael S. Gibson, Division of Banking Supervision and Regulation
Sandra F. Braunstein, Division of Consumer and Community Affairs
William Mitchell, Division of Financial Management
Steven B. Kamin, Division of International Finance
Sharon Mowry, Division of Information Technology
Scott G. Alvarez, Legal Division
William English, Division of Monetary Affairs
Michell Clark, Management Division
Nellie Liang, Office of Financial Stability Policy and Research
Robert deV. Frierson, Office of the Secretary
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Introduction

Objective

Our objective for this audit was to determine the processes for establishing, maintaining, and monitoring internal control within the Board of Governors of the Federal Reserve System (Board). Our audit focused on the internal control over the effectiveness and efficiency of operations and compliance with laws and regulations, i.e., administrative internal control. Administrative controls address programmatic, operational, and administrative areas. Our scope does not include internal control over financial reporting or information systems because the Board issues a management assertion on internal control over financial reporting and complies with the Federal Information Security Management Act of 2002, which requires agencies to establish and maintain an information security program to protect information and information systems. Additional detail on our scope and methodology is in appendix A.

Background

Internal control is an integral part of managing an organization and is critical to improving organizational effectiveness and accountability. It comprises the plans, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal control is the first line of defense in safeguarding assets and preventing and detecting errors and fraud and, thus, helps organizations achieve desired results through effective stewardship of public resources. Internal control should provide reasonable assurance that the objectives of the organization are being achieved in the following categories: (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with applicable laws and regulations.

The Board's long-standing mission is to foster stability, integrity, and efficiency in the nation's monetary, financial, and payment systems in pursuit of optimal macroeconomic performance. In carrying out its mission, the Board has stated that it is continually aware that its operations are supported primarily by public funds, it is accountable and responsive to the public, and it recognizes its obligation to manage resources efficiently and effectively while providing transparency and accountability.¹

1. The Board is an independent federal government agency that does not receive funding appropriated by Congress. The Federal Reserve System's income is derived primarily from the interest on U.S. government securities that it has acquired through open market operations. After paying its expenses, the Federal Reserve System turns the rest of its earnings over to the U.S. Treasury.

Federal Managers' Financial Integrity Act of 1982

Congress has long recognized the importance that internal control plays in achieving organizational effectiveness and accountability. In 1982, when faced with several highly publicized internal control breakdowns, including disclosures of waste, loss, unauthorized use, and misappropriation of funds across a wide spectrum of government operations, Congress passed the Federal Managers' Financial Integrity Act of 1982 (FMFIA) to help reduce fraud, waste, and abuse, as well as to enhance the management of federal government operations through improved internal control.

FMFIA requires the Government Accountability Office (GAO) to establish internal control standards (*Standards for Internal Control in the Federal Government*) and the Office of Management and Budget (OMB) to issue guidelines (*Circular A-123—Management's Responsibility for Internal Control*) for agencies to follow in assessing and reporting on their internal control. In addition, FMFIA requires that each executive agency establish internal accounting and administrative controls in compliance with GAO's standards and evaluate and report annually on internal control using OMB guidelines.

Under its long-standing legal interpretation, the Board is not required to comply with FMFIA because it is a financially related statute that is made inapplicable to the Board by section 10 of the Federal Reserve Act.² However, in 1983, shortly after the enactment of FMFIA, the Board's Controller issued a memorandum to the Board's Staff Director for Management stating that it would be in the Board's best interest to comply with the spirit and intent of FMFIA.³ The Board's approach to addressing FMFIA was described in this memorandum as well as in later correspondence in 1984 and 1988. The Board's approach to addressing FMFIA remains unchanged since the correspondence from the 1980s.

Standards for Internal Control

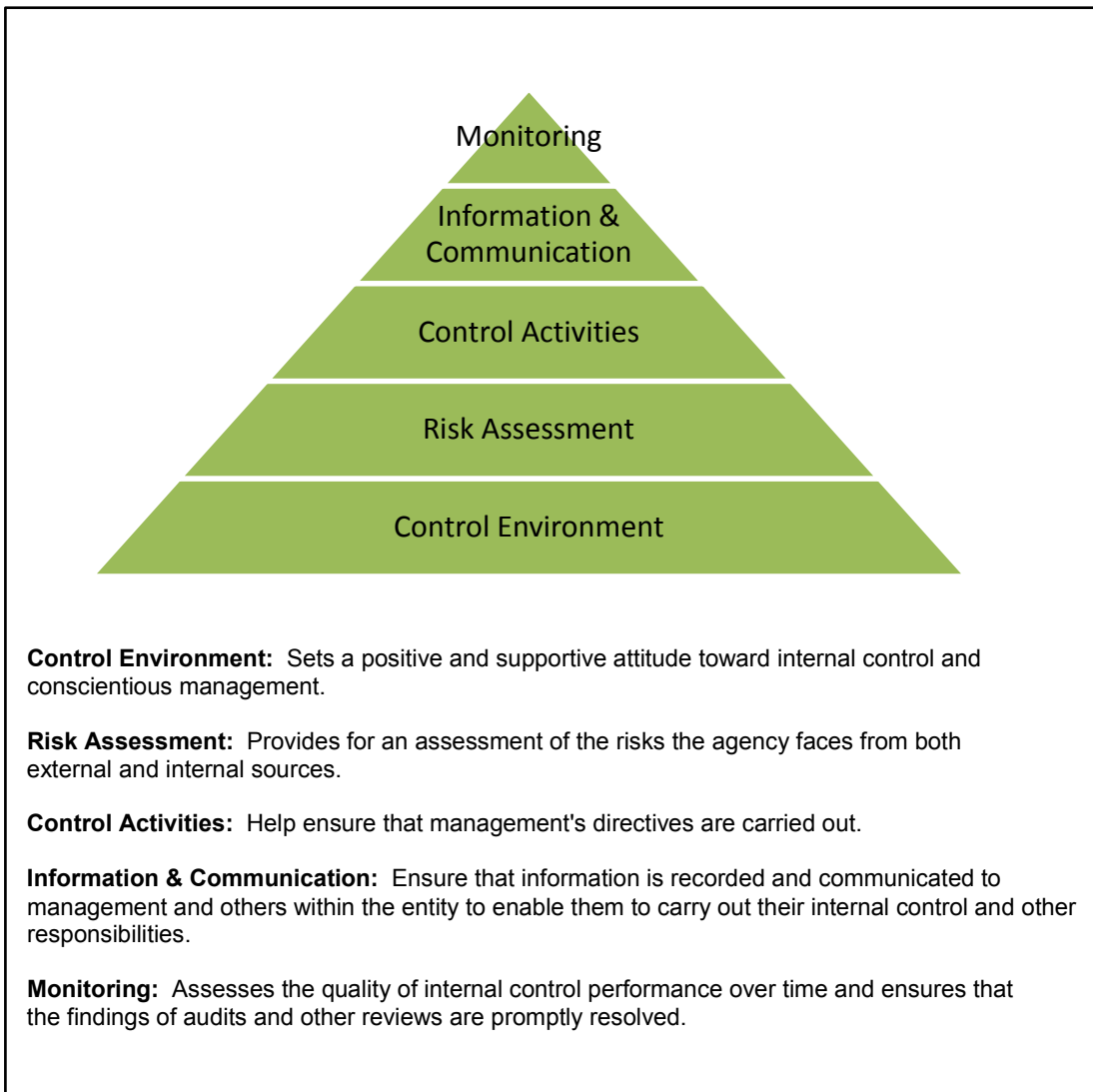
In accordance with FMFIA, GAO issued *Standards for Internal Control in the Federal Government* in 1983. To address changes in information technology and financial systems, GAO revised and reissued its standards in November 1999. The revised standards include five standards for internal control and provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance challenges and areas at greater risk for fraud, waste, abuse, and mismanagement (figure 1).

The revised GAO standards also incorporate the private sector's *Internal Control—Integrated Framework* published by the Committee of Sponsoring Organizations of the Treadway

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2. Section 10 of the Federal Reserve Act empowers the Board to "determine and prescribe the manner in which its obligations shall be incurred and its disbursements and expenses allowed and paid." 12 U.S.C. § 244.
 3. The positions of Controller and Staff Director for Management no longer exist within the current Board organizational structure.

Commission (COSO).⁴ The COSO framework was recently updated to include enhancements and clarifications that are intended to increase ease of use and broaden application. The new COSO framework provides clarity for understanding requirements for effective internal control and expands reporting to include nonfinancial and internal reporting. It also reflects changes in the business and operating environments, including governance oversight, demands and complexities in laws and regulations, and expectations for competencies and accountabilities.

Figure 1: GAO's Standards for Internal Control in the Federal Government



4. COSO's internal control framework is widely used and recognized as a leading framework for designing, implementing, and evaluating the effectiveness of internal control. It integrates various internal control concepts into a framework in which a common definition is established and control components are identified. COSO's internal control framework was updated in May 2013 with a transition period ending December 15, 2014.

Responsibility for Internal Control

In anticipation of FMFIA's enactment, OMB issued Circular A-123, then titled *Internal Control Systems*, in 1981. In 1982, following FMFIA's enactment, OMB issued the assessment guidelines required by FMFIA. Circular A-123 has been periodically updated over the years and is now titled *Management's Responsibility for Internal Control*. The updated circular emphasizes the need for agencies to integrate and coordinate internal control assessments with other internal control-related activities. The circular provides information on improving the accountability and effectiveness of programs and operations by establishing, assessing, correcting, and reporting on internal control. Internal control guidance can be found in GAO's *Standards for Internal Control in the Federal Government*, OMB's Circular A-123, as well as COSO's *Internal Control—Integrated Framework*. Below are excerpts from those documents.

Establishing Internal Control

Management is responsible for developing and maintaining effective internal control. Management sets the objectives, defines organizational programs and operations, performs risk assessments to identify the most significant areas within those programs and operations, communicates the objectives of internal control to the organization, and implements the control activities to minimize risks. Some examples of internal control activities are

- policies and procedures
- segregation of duties
- reviews by management at the functional or activity level
- appropriate documentation of transactions and internal control
- access restrictions to and accountability for resources and records

As part of this process, management should take systematic and proactive measures to develop and implement appropriate, cost-effective internal control.

While management is responsible for developing and maintaining effective internal control, internal control is accomplished by all personnel in an organization. Internal control recognizes that personnel do not always understand, communicate, or perform consistently. Accordingly, a clear and close linkage must exist between personnel's duties and the way in which they are carried out, as well as between personnel's duties and the organization's objectives. Personnel should know their responsibilities and the limits of their authority. Further, internal control should be clearly documented, and the documentation should be readily available for examination. All documentation and records should be properly managed and maintained.

Maintaining and Monitoring Internal Control

Managers should continually assess and evaluate internal control. Once-effective procedures can become less effective over time, or the application of controls may change. Such changes can result from the arrival of new personnel, the variability of training and supervision, time and resource constraints, or other factors. Monitoring ensures that internal control continues to operate effectively and is accomplished by (1) appropriate personnel assessing the design and

operation of controls on a suitably timely basis and (2) management taking necessary actions to address any issues.

Monitoring can be done through ongoing activities or separate evaluations. Ongoing monitoring occurs during the course of normal operations; separate evaluations of specific processes take place after the processes have been performed. Ongoing monitoring is effective because it is performed on a real-time basis, it reacts dynamically to changing conditions, and it is ingrained in the organization. However, separate evaluations provide an opportunity to consider the continued effectiveness of ongoing monitoring. Therefore, a combination of ongoing monitoring and separate evaluations will usually ensure that the internal control maintains its effectiveness over time.

The final stage of monitoring involves reporting findings and deficiencies on a timely basis to appropriate personnel. Reporting enables the results of monitoring to either confirm previously established expectations about the effectiveness of internal control or highlight identified deficiencies for possible corrective action. The basis for reporting on internal control can include a variety of information sources including Office of Inspector General (OIG) and GAO reports, management reviews, and annual evaluations pursuant to statutory requirements; however, management should use its own judgment to assess and report on internal control and use other sources of information as supplements.

Finding: The Board Does Not Have an Agency-Wide Process for Maintaining and Monitoring Administrative Internal Control

We found that the Board's divisions have processes for establishing administrative internal control that are tailored to their specific responsibilities. These controls generally utilize best practices and are designed to increase efficiency and react to changing environments. A few of the divisions' functional areas formally maintain and monitor their controls. However, the Board's processes for maintaining and monitoring these internal controls can be enhanced. Specifically, we found that the Board does not have an agency-wide process for maintaining, monitoring, and reporting on its administrative internal control. Although the Board is not subject to FMFIA, the Board decided to voluntarily comply with the spirit and intent of FMFIA. The Board's approach to addressing the provisions of FMFIA does not require management to assess and monitor administrative internal control. GAO has emphasized the benefits of internal control, and during our audit we performed benchmarking against other independent agencies that voluntarily follow FMFIA as a best practice. We believe that an agency-wide process that maintains, monitors, and reports on administrative internal control can assist the Board in effectively and efficiently achieving its mission, goals, and objectives, as well as address organizational challenges outlined in the Board's 2012–2015 strategic framework.

The Board Has Not Implemented an Agency-Wide Process for Maintaining and Monitoring Administrative Internal Control

During our audit, we found that the Board's functional areas have processes for establishing internal control. The types of internal controls implemented differ by functional area because they are tailored to their specific responsibilities. For example, we found that some functional areas have implemented automated processes to increase efficiency while others have documented their procedures to ensure consistency as environments may change. In general, we found that functional areas developed their internal controls as they recognized the need to mitigate risks.

Although the Board's divisions have processes for establishing internal controls, we found that the Board does not have an agency-wide process for maintaining, monitoring, and reporting on administrative internal control. A few of the divisions' functional areas do formally maintain and monitor their controls through regular updates to policies and procedures, continuous evaluation of a process, or internal business reviews. For example, functional areas in multiple divisions that are responsible for providing economic analyses to support monetary policy decisionmaking have created a committee to periodically review their process and ensure that it is up-to-date. Other functional areas have set schedules for reviewing their procedures to ensure they are up-to-date. Some of these functional areas maintain and monitor their controls because they are reviewed periodically by outside agencies. Two of these functional areas perform and submit self-assessments to those outside agencies. However, we found that the majority of the functional areas do not formally maintain and monitor their administrative internal controls. The functional areas that do not maintain and monitor their administrative internal controls update them on an

as-needed basis, such as when a process changes or new guidance is issued, rather than as a result of monitoring.

The Board's Approach to Complying with FMFIA in Spirit and Intent Does Not Require Management to Assess and Monitor Administrative Internal Control

In a series of correspondence from 1983 to 1988, the Board stated its intent to comply with the spirit and intent of FMFIA. Since that time, the Board's approach to addressing the provisions of FMFIA has relied on work already being conducted, such as the examination of the Board's financial statements by independent auditors as well as independent reviews by the OIG and GAO. In addition, the Board stated that its approach to meeting the reporting provisions of FMFIA is through reports the Board provides to Congress, such as the Board's annual report and the OIG's semiannual reports. However, this approach does not require any action by the Board's divisions and does not include maintaining, monitoring, and reporting on administrative internal control.

FMFIA guidance states that management has primary responsibility for assessing and monitoring controls associated within their programs and should use other sources as a supplement to, not a replacement for, its own judgment when assessing and reporting on internal control. The guidance also states that continuous monitoring and other periodic assessments should provide the basis for the agency's assessment of its internal control. Therefore, although the OIG and GAO perform independent reviews of the Board's programs and operations, their reports should not replace Board management's own judgment for assessing and reporting on administrative internal control.

Complying with FMFIA Is a Best Practice

GAO has emphasized the benefits of internal control. GAO monitored and reported on initial FMFIA implementation efforts across the government in a series of reports as well as in numerous reports targeting specific agencies and programs. Specifically, GAO reported that agencies noted moderate or better senior management support for a strong internal control review process and for reporting weaknesses identified and making the needed improvements as a result of implementing FMFIA. GAO also reported that federal managers generally perceived that positive impacts, such as improved internal control and program efficiency and effectiveness, have resulted from FMFIA. In February 2005, GAO testified before Congress that controls at agencies had improved and that agencies had implemented logical, cohesive, and coordinated agency-wide approaches to identifying and correcting internal control problems.

During our benchmarking, we met with management at one executive agency that is required to comply with FMFIA (Agency 1) and two independent agencies that voluntarily follow FMFIA as

a best practice (Agency 2 and Agency 3).⁵ Management from Agencies 2 and 3 stated to us that they recognize the importance of internal control and therefore decided to follow FMFIA. Both of the agencies stated that accountability was recognized as one of the benefits of following FMFIA. Agency 2 also stated that its FMFIA process allows business units to proactively focus on their areas of highest risk.

We found only minor differences in the approach of the agency required to comply with FMFIA as compared with the agencies that voluntarily follow FMFIA. Specifically, we found that all three agencies have developed an agency-wide process for evaluating and reporting on internal control. For example, all three agencies have designated officials responsible for FMFIA compliance at the agency level. Within these agencies, each business unit performs internal control reviews and provides an assurance statement to the head of the agency concerning the adequacy of their internal control, including deficiencies identified during their assessments. In addition, using the assurance statements provided by the business units, the heads of each of the three agencies publicly issue a consolidated assurance statement on the adequacy of the agency's internal control. One of the agencies that voluntarily follows FMFIA has also implemented a policy for FMFIA compliance and has established a senior oversight council. The other agency stated that it is planning to implement a policy for FMFIA compliance and establish a senior oversight council in the near future. Both agencies placed great emphasis on the importance of educating their staffs regarding internal control.

A comparison of the FMFIA implementation approaches of the benchmarked agencies is in table 1.

Table 1: Benchmarking Summary, FMFIA Section 2^a

FMFIA Implementation	Agency 1	Agency 2	Agency 3
Required to comply with FMFIA	Yes	No	No
Designated officials responsible for FMFIA compliance	Yes	Yes	Yes
Developed an agency-wide policy regarding FMFIA compliance	Yes	Yes	No ^b
Established an oversight council	Yes	Yes	No ^c
Conduct internal control reviews and program evaluations of the business lines	Yes	Yes	Yes
Provide an assurance statement concerning the adequacy of business units' internal control to the agency head	Yes	Yes	Yes
Include all the deficiencies identified throughout the unit in the assurance letter, which is forwarded to the agency head	Yes	Yes	Yes
Publicly issues an annual assurance statement	Yes	Yes	Yes

Source: OIG compilation of benchmarking results.

^aSection 2 of FMFIA deals with accounting and administrative internal controls.

^bDuring our interview, agency officials stated that they were planning to develop an agency policy for FMFIA compliance.

^cDuring our interview, agency officials stated that they were planning to create an oversight council in the future.

5. Agency 1 is required to comply with FMFIA and was included in our benchmarking to gain an understanding of how an executive agency implemented FMFIA. This agency was used as the basis of comparison to the agencies that voluntarily comply with FMFIA.

Maintaining and Monitoring Administrative Internal Control Can Help the Board Achieve Its Mission, Goals, and Objectives

Maintaining and monitoring administrative internal control can help the Board respond to shifting environments and evolving demands and priorities by ensuring that the control activities being used are effective and updated when necessary. While the Board's broad mission of fostering stability, integrity, and efficiency in the nation's monetary, financial, and payment system remains essentially unchanged, the 2007–2009 financial crisis fundamentally changed how the Board operates within its functional disciplines. To address these changes, the Board developed a strategic framework for 2012–2015 that addresses the most critical organizational challenges, such as retaining the right mix of skills and expertise, data governance, and facilities upgrades. As the Board's programs change to meet the strategic framework goals, established control activities can become less effective due to changing conditions. Maintaining and monitoring established control activities to address organizational challenges can help the Board ensure that the internal controls implemented are adequately designed and continue to work over time and that control failures and risks are identified, corrected, and mitigated on a timely basis.

We believe that an agency-wide process for maintaining, monitoring, and reporting on internal control can assist the Board in achieving its mission, goals, and objectives; lead to organizational efficiencies; and help avoid and address potential and actual problems that might prevent the Board from carrying out its mission effectively and efficiently or complying with laws and regulations. Prior OIG work products have identified internal control weaknesses at the Board, including noncompliance with policies and procedures, inadequate access control, and the premature release of confidential information. Although these internal control weaknesses did not prevent the Board from carrying out its mission or achieving its strategic objectives, they introduced operational and reputational risks. An agency-wide process for maintaining and monitoring administrative internal control can allow the Board to (1) identify and prevent or correct internal control weaknesses in a timely manner; (2) reduce costs because problems are identified and addressed in a proactive, rather than reactive, manner; (3) produce more accurate and reliable information for use in decisionmaking; and (4) provide periodic assertions on the effectiveness of internal control.

Conclusion

Recognizing the importance of FMFIA, the Board decided to voluntarily comply with the spirit and intent of the legislation. However, the Board's approach to FMFIA compliance does not include an agency-wide process for evaluating and reporting on administrative internal control. During our benchmarking, we found that other agencies that are not required to follow FMFIA have developed an agency-wide process for evaluating and reporting on administrative internal control. Maintaining and monitoring administrative internal control can provide management with reasonable assurance that the Board is effectively and efficiently achieving its mission, goals, and objectives and complying with laws and regulations. We believe an agency-wide approach that more closely follows and addresses the spirit and intent of FMFIA would allow the Board to maximize the benefit from its internal control and could contribute to the Board's ongoing commitment to accountability and effective and efficient operations.

Recommendation

We recommend that the Chief Operating Officer

1. Designate responsible officials or an office to
 - a. develop and implement an agency-wide policy and process to more closely follow the spirit and intent of FMFIA.
 - b. develop a training program to increase staff awareness about maintaining and monitoring administrative internal control.

Management's Response

Regarding our recommendation, the Board's Chief Operating Officer (COO) stated the following:

Concur with the recommendation's intent. We agree that effectively establishing, maintaining, and monitoring administrative internal controls can assist the Board in achieving its goals and objectives and in complying with laws and regulations. We also agree that there are opportunities to enhance our current practices related to administrative internal controls. To that end, we have already implemented, or are in the process of implementing, several enhanced administrative processes. For example, we are establishing within the Division of Financial Management a central tracking point for all audit, inspection, evaluation, or other similar reports pertaining to any Board functional area. This will allow us to better monitor findings across the organization and identify trends and opportunities to more broadly strengthen administrative internal controls. We have also established a comprehensive process for regularly reviewing and updating all of our management policies to ensure that the policies and the underlying practices and associated controls remain up-to-date; I receive regular reports on the status of this activity.

The audit report notes that shortly after FMFIA was enacted, as well as in later correspondence in 1984 and 1988, staff recommended that the Board comply with the spirit and intent of FMFIA. It is unclear, however, from this correspondence whether the Board officially adopted this recommendation or exactly what staff intended in establishing a FMFIA-compliant program. Given the priorities and budgetary constraints underlying the Board's new strategic framework, we believe that creating additional infrastructure to develop and implement policies and processes, to include developing a training program, must be carefully balanced with other competing resource priorities. We will evaluate whether, and in what form, an agency-wide framework makes sense and coordinate with the Executive Committee of the Board to implement any additional requirements.

OIG Comment

The COO acknowledged that there are opportunities to enhance the Board's current practices related to administrative internal controls and provided two examples of enhancements that have been implemented or are in the process of being implemented. The COO stated that the Board has established a comprehensive process for regularly reviewing and updating all management policies. We agree that this is a method of maintaining and monitoring internal control over those management policies; however, this process addresses only one of the Board's functions. We believe that this is a good example of a method by which other functional areas in other divisions can keep their policies and procedures up to date. In addition, the COO stated that the Division of Financial Management is establishing a central tracking point for all audit, inspection, evaluation, and other similar reports. While a tracking system will assist the Board in monitoring the areas that have been reviewed by others, FMFIA and COSO guidance state that management should continually assess and evaluate internal control and should use other sources as a supplement to, not as a replacement for, its own judgment when assessing and reporting on internal control.

The COO also stated in his response that it is unclear whether the Board officially adopted a staff recommendation included in the correspondence from the 1980s to comply with the spirit and intent of FMFIA. Further, the COO stated in his response that it is unclear what the staff recommendation intended regarding the establishment of a FMFIA-compliant program. While we did not find evidence that the Board officially adopted a staff recommendation to comply with the spirit and intent of FMFIA, correspondence from the 1980s from the Vice Chairman of the Board and others indicate support for complying with the spirit and intent of FMFIA.

Concerning our audit recommendation, the COO stated that implementing policies and processes, to include developing a training program, must be balanced with other competing resource priorities as detailed in the Board's new strategic framework. He plans to evaluate whether, and in what form, an agency-wide framework makes sense and coordinate with the Executive Committee of the Board to implement any additional requirements. We recognize that the Board has priorities and resource constraints, but we believe that an agency-wide process for maintaining and monitoring administrative internal control can help the Board manage changes that may result from implementing the strategic framework and further the Board's goal of increasing the efficiencies of its operations. As we stated in our report, change can decrease the effectiveness of the Board's control activities. Therefore, maintaining and monitoring established control activities to address organizational challenges can help the Board ensure that the internal controls implemented are adequately designed and continue to work over time and that control failures and risks are identified, corrected, and mitigated in a timely manner. Based on our benchmarking and the emphasis on the benefits of internal control throughout the federal government, we strongly believe it is in the Board's best interest to more closely follow the spirit and intent of FMFIA.

The Inspector General Act, as amended, requires that we report in our Semiannual Report to Congress on recommendations for which no management decision has been made. The act defines a management decision as the issuance of a final decision by management concerning its response to audit findings and recommendations, including actions concluded to be necessary. Since the COO's response indicated that he had not yet determined the final actions he would take to address our report's findings, we are requesting that he provide us within 90 calendar days a final management decision describing the actions taken or planned to address our recommendation.

Appendix A

Scope and Methodology

To accomplish our objective, we reviewed FMFIA and applicable guidance, including GAO's *Standards for Internal Control in the Federal Government*, GAO's Internal Control and Management Evaluation Tool, OMB Circular A-123, and COSO publications. We also reviewed previous audit reports issued by our office as well as by GAO.

We met with personnel in 12 of the 14 Board divisions to provide background information on internal control and the process for maintaining and monitoring internal control, and to gain a high-level understanding of administrative internal control processes in place in the divisions.⁶ Following the initial meetings, the divisions provided the audit team with points of contact in a variety of functional areas in each of the divisions. The audit team held over 70 meetings across the 12 divisions, including follow-up meetings with points of contact in functional areas for each division, to determine their administrative internal control processes. We then reviewed documentation of those administrative internal controls. Although we reviewed the internal control documentation, we did not test any of the controls in place nor did we make a determination on the adequacy of the controls.

We discussed the process for establishing internal control with selected functional areas. We also benchmarked with three federal agencies to gain an understanding of their processes for maintaining and monitoring their internal controls. One of these agencies is required to comply with FMFIA, while the other two follow it voluntarily.

Our audit addressed section 2 of FMFIA (internal accounting and administrative control) and not section 4 (financial accounting systems). We focused on internal control over the effectiveness and efficiency of operations and compliance with laws and regulations, i.e., administrative controls, because the Board voluntarily complies with Sarbanes-Oxley section 404, which requires management to assert that it is responsible for creating, maintaining, and assessing the effectiveness of internal control over financial reporting. Further, we did not assess internal control over information systems because the Board complies with the Federal Information Security Management Act of 2002, which requires agencies to establish and maintain an information security program and implement controls to protect information and information systems that support the operations and assets of the agency.

We conducted our audit fieldwork from March 2012 to May 2013. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We

6. We did not include the OIG in the scope of this audit because we are not independent with regard to the OIG's internal control activities. We did not meet with the Division of Financial Management because it was created during our fieldwork phase.

believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Appendix B

Management's Response



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, DC 20551

OFFICE OF THE
CHIEF OPERATING OFFICER

DATE: July 15, 2013
TO: Melissa Heist
FROM: Don Hammond *DH*
SUBJECT: Response to the OIG's OIG Draft Report: *The Board Can Benefit from Implementing an Agency-wide Process for Maintaining and Monitoring Administrative Internal Control*

We appreciate the opportunity to comment on the draft report of the OIG's audit work related to the processes for establishing, maintaining, and monitoring internal control within the Board of Governors of the Federal Reserve System (Board). As the report notes, the Board's divisions have developed processes for establishing administrative internal controls that are tailored to their specific responsibilities. We are pleased that the report found that these controls generally utilize best practices and are designed to increase efficiency and react to changing environments. The following comments provide additional perspective on the report's recommendation and management's planned actions to further enhance our processes.

Recommendation 1: We recommend that the Chief Operating Officer designate responsible officials or an office to:

- a. **develop and implement an agency-wide policy and process to more closely follow the spirit and intent of the Federal Managers' Financial Integrity Act (FMFIA), and**
- b. **develop a training program to increase staff awareness about maintaining and monitoring administrative internal control.**

COO Response:

Concur with the recommendation's intent. We agree that effectively establishing, maintaining, and monitoring administrative internal controls can assist the Board in achieving its goals and objectives and in complying with laws and regulations. We also agree that there are opportunities to enhance our current practices related to administrative internal controls. To that end, we have already implemented, or are in the process of implementing, several enhanced administrative processes. For example, we are establishing within the Division of Financial Management a central tracking point for all audit, inspection, evaluation, or other similar reports pertaining to any Board functional area. This will allow us to better monitor findings across the organization and identify trends and opportunities to more broadly strengthen administrative internal

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controls. We have also established a comprehensive process for regularly reviewing and updating all of our management policies to ensure that the policies and the underlying practices and associated controls remain up-to-date; I receive regular reports on the status of this activity.

The audit report notes that shortly after FMFIA was enacted, as well as in later correspondence in 1984 and 1988, staff recommended that the Board comply with the spirit and intent of FMFIA. It is unclear, however, from this correspondence whether the Board officially adopted this recommendation or exactly what staff intended in establishing a FMFIA-compliant program. Given the priorities and budgetary constraints underlying the Board's new strategic framework, we believe that creating additional infrastructure to develop and implement policies and processes, to include developing a training program, must be carefully balanced with other competing resource priorities. We will evaluate whether, and in what form, an agency-wide framework makes sense and coordinate with the Executive Committee of the Board to implement any additional requirements.

BC:
Bill Mitchell
Kit Wheatley



OFFICE OF INSPECTOR GENERAL

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
CONSUMER FINANCIAL PROTECTION BUREAU

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