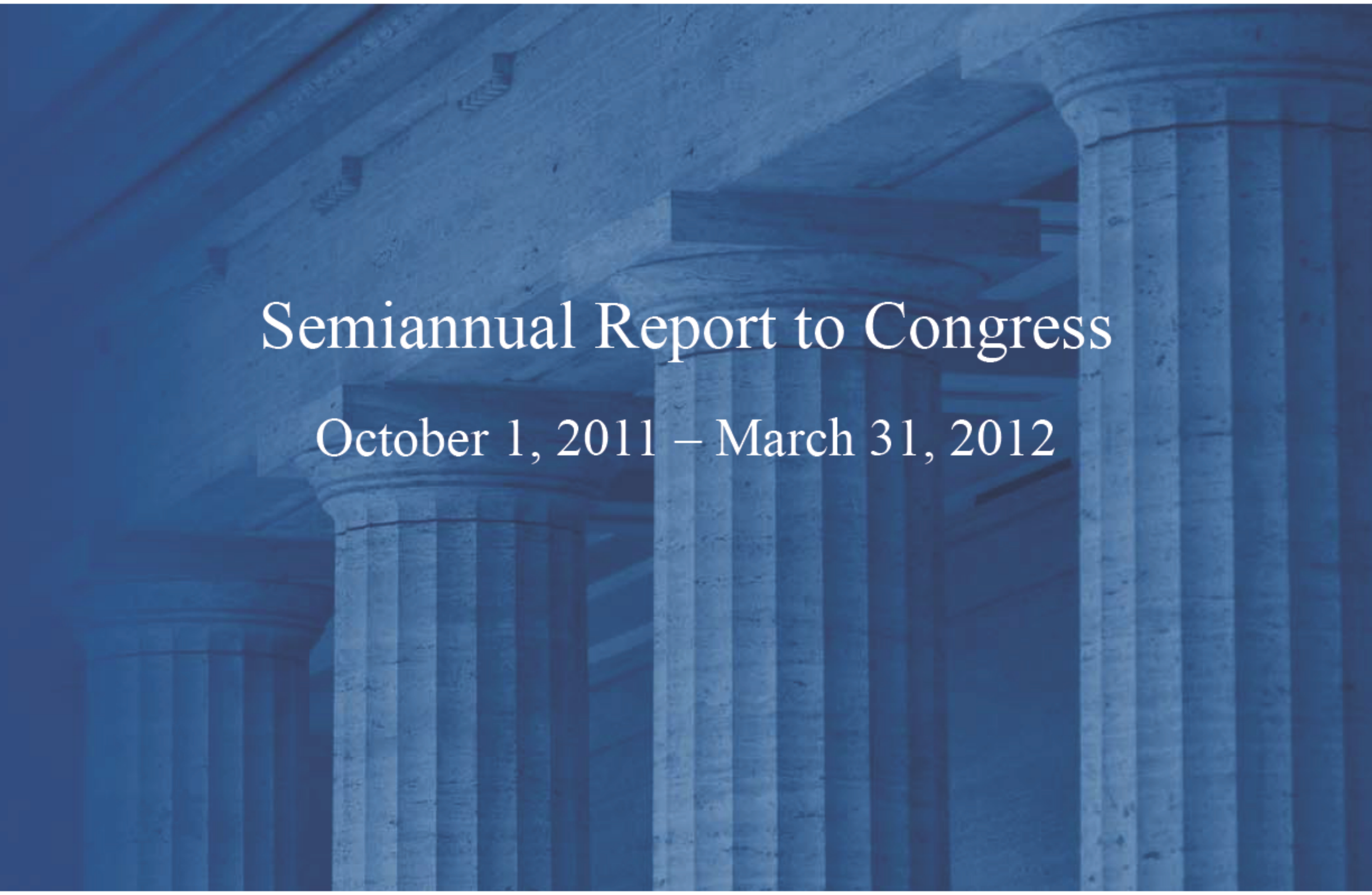
Office of Inspector General

Semiannual Report to Congress

October 1, 2011 – March 31, 2012



Board of Governors of the Federal Reserve System

Consumer Financial Protection Bureau

Message from the Inspector General

On behalf of the Office of Inspector General (OIG) of the Board of Governors of the Federal Reserve System (Board) and the Consumer Financial Protection Bureau (CFPB), I am pleased to present our *Semiannual Report to Congress* highlighting our accomplishments and ongoing work for the six-month period ending March 31, 2012. This is a dynamic time for both agencies, as well as the OIG, and we are proud of the work that we have performed and the reports we have issued.

Of particular note this reporting period, we issued our *Inquiry into Allegations of Undue Political Interference with Federal Reserve Officials Related to the 1972 Watergate Burglary and Iraq Weapons Purchases during the 1980s*; three failed bank reviews, with associated estimated losses to the Deposit Insurance Fund of $653.9 million; the financial statement audits for the Board and the Federal Financial Institutions Examination Council, both of which received "clean," unqualified opinions; and our annual Federal Information Security Management Act of 2002 audit reports for the Board and the CFPB. Further, during this reporting period the president and chief executive officer of Orion Bank entered a guilty plea to a criminal information in which he was charged with conspiring to commit bank fraud, misapplying bank funds, making false entries in the bank's books and records, and obstructing a bank examination.

The OIG also issued its 2012 annual plan after conducting extensive risk analysis that included meetings with Board and CFPB officials to gain their insight on the most significant challenges and issues facing their programs and operations. The OIG also engaged in extensive strategic planning meetings internally to draw upon the experience and expertise of our employees. The resultant annual plan provides for cross-cutting oversight of the Board and the CFPB to help ensure the economy, efficiency, and effectiveness of the agencies' programs and activities. Our annual plan is posted on our website at http://m-fwapp3p.frb.gov/OIG/strategicPlan/2012%20Annual%20Plan_02-10-12_web.pdf.

To assist us in providing appropriate oversight of the Board's and the CFPB's programs and activities, the OIG is expanding its staff, as well as establishing regional offices, to enable more timely and effective coverage of audit, inspection, and investigative matters occurring outside of the Washington, D.C., area. We are working to establish regional offices in New York, Chicago, San Francisco, and Miami, and we hope to have them all operational this calendar year.

I want to express my appreciation to the Board and the CFPB for their cooperation and support of the work of the OIG.

Sincerely,

Mark Bialek
Inspector General
April 30, 2012

Office of Inspector General

Semiannual Report to Congress

October 1, 2011–March 31, 2012

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Highlights

Consistent with our responsibilities under the Inspector General Act of 1978, as amended (IG Act), and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Office of Inspector General (OIG) continued to promote the integrity, economy, efficiency, and effectiveness of the programs and operations of the Board of Governors of the Federal Reserve System (Board) and the Consumer Financial Protection Bureau (CFPB). The following are highlights of our work during this semiannual reporting period.

- **Special Inquiry.** We issued our final report on our *Inquiry into Allegations of Undue Political Interference with Federal Reserve Officials Related to the 1972 Watergate Burglary and Iraq Weapons Purchases during the 1980s*. We initiated this inquiry in response to a request from the then Chairman of the House Committee on Financial Services to the Board for an investigation into allegations raised by a member of Congress during the February 2010 Humphrey-Hawkins hearing. The Board referred the request to our office for action. We performed this inquiry to identify and assess any available evidence of undue political interference with Federal Reserve officials related to the 1972 Watergate burglary and Iraq weapons purchases during the 1980s. Regarding the specific Watergate allegations, we did not find any evidence of undue political interference with or improper actions by Federal Reserve officials related to the cash found on the Watergate burglars. We also did not find any evidence of undue political interference with Federal Reserve officials or inaccurate responses by Board officials regarding an allegation that the Federal Reserve officials "stonewalled" congressional members and staff regarding the source of the cash found on the burglars. With regard to the Iraq allegation, we did not find any evidence of undue political interference with Federal Reserve officials or any indications that the Federal Reserve facilitated a $5.5 billion loan to Saddam Hussein or Iraq for weapons purchases during the 1980s. We also did not find evidence of any loans between the Federal Reserve and Saddam Hussein or Iraq during the 1980s.

- **Failed Bank Reviews.** We completed three failed bank reviews during the reporting period, with associated total estimated assets of $2.0 billion and losses to the Deposit Insurance Fund (DIF) of $653.9 million. For each bank reviewed, we identified the causes of the failure, supervisory issues/concerns, and lessons learned from the failure.

- **Financial Statement Audits.** We issued the financial statement audits for the Board and the Federal Financial Institutions Examination Council (FFIEC), both of which received "clean," unqualified opinions. We contracted with Deloitte & Touche LLP, an independent public accounting firm, to conduct the audits, and we oversaw its work.

- **Annual Information Security Audits.** We completed our annual Federal Information Security Management Act of 2002 (FISMA) audits of the Board and the CFPB. We found that the Board continued to maintain a FISMA-compliant approach to its Information Security Program. Regarding the CFPB, we found that it is relying on the Information Security Program and computer systems of the Department of the Treasury (Treasury), and we relied on the FISMA work of the Treasury OIG to avoid duplication of effort. KPMG LLC, an independent certified public accounting firm, conducted the Treasury OIG's 2011 FISMA audit and concluded that Treasury's Information Security Program and practices for its non-Internal Revenue Service bureaus' unclassified systems were generally consistent with the requirements of FISMA.

- **Bank President Pleads Guilty.** The president and chief executive officer of Orion Bank entered a guilty plea to a criminal information in which he was charged with conspiring to commit bank fraud, misapplying bank funds, making false entries in the bank's books and records, and obstructing a bank examination. The charges relate to his role in a scheme to lend $82 million to "straw" borrowers acting on behalf of an Orion Bank borrower who had reached the bank's legal lending limit. Additionally, the loans concealed $15 million in bank funds to be used for the purchase of Orion stock by the above-mentioned borrower, in violation of banking laws and regulations.

Introduction

Congress established the OIG as an independent oversight authority within the Board, the government agency component of the broader Federal Reserve System. In addition, the Dodd-Frank Act established the OIG as the independent oversight authority for the CFPB. Within this framework, the OIG conducts audits, investigations, and other reviews related to Board and CFPB programs and operations. By law, the OIG is not authorized to perform program functions.

Consistent with the IG Act, our office, as the OIG for the Board and the CFPB,

- conducts and supervises independent and objective audits, investigations, and other reviews related to Board and CFPB programs and operations

- promotes economy, efficiency, and effectiveness within the Board and the CFPB

- helps prevent and detect fraud, waste, abuse, and mismanagement in Board and CFPB programs and operations

- reviews existing and proposed legislation and regulations and makes recommendations regarding possible improvements to Board and CFPB programs and operations

- keeps the Board of Governors, the Director of the CFPB, and Congress fully and timely informed

Congress has also mandated additional responsibilities that influence the OIG's priorities, to include the following:

- Section 38(k) of the Federal Deposit Insurance Act (FDI Act) requires that the OIG review failed financial institutions supervised by the Board that result in a material loss to the DIF and produce a report within six months. The Dodd-Frank Act amended section 38(k) of the FDI Act by raising the materiality threshold, but also by requiring that the OIG report on the results of any nonmaterial losses to the DIF that exhibit unusual circumstances that warrant an in-depth review.

- Section 211(f) of the Dodd-Frank Act requires that the OIG review the Board's supervision of any covered financial company that is placed into receivership and produce a report that evaluates the effectiveness of the Board's supervision, identifies any acts or omissions by the Board that contributed to or could have prevented the company's receivership status, and recommends appropriate administrative or legislative action.

- Section 989E of the Dodd-Frank Act established the Council of Inspectors General on Financial Oversight (CIGFO), which comprises the Inspectors General (IGs) of the Board, the Commodity Futures Trading Commission (CFTC), the Department of Housing and Urban Development, Treasury, the Federal Deposit Insurance Corporation (FDIC), the Federal Housing Finance Agency (FHFA), the National Credit Union Administration (NCUA), and the Securities and Exchange Commission (SEC) and the Special Inspector General for the Troubled Asset Relief Program (SIGTARP). CIGFO is required to meet at least quarterly to share information and discuss the ongoing work of each IG, with a focus on concerns that may apply to the broader financial sector and ways to improve financial oversight. Additionally, CIGFO is required to issue a report annually that highlights the IGs' concerns and recommendations, as well as issues that may apply to the broader financial sector.

- With respect to information technology (IT), FISMA established a legislative mandate for ensuring the effectiveness of information security controls over resources that support federal operations and assets. Consistent with FISMA requirements, we perform an annual independent evaluation of the Board's and the CFPB's Information Security Programs and practices, including the effectiveness of security controls and techniques for selected information systems.

- The USA Patriot Act of 2001, Public Law No. 107-56, grants the Board certain federal law enforcement authorities. Our office serves as the external oversight function for the Board's law enforcement program.

- Section 11B of the Federal Reserve Act mandates annual independent audits of the financial statements of each Federal Reserve Bank and of the Board. We oversee the annual financial statement audits of the Board, as well as the FFIEC. (Under the Dodd-Frank Act, the Government Accountability Office performs the financial statement audits of the CFPB.) The FFIEC is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board, the FDIC, the NCUA, the Office of the Comptroller of the Currency (OCC), and the CFPB and to make recommendations to promote uniformity in the supervision of financial institutions. In 2006, the State Liaison Committee was added to the FFIEC as a voting member. The State Liaison Committee includes representatives from the Conference of State Bank Supervisors, the American Council of State Savings Supervisors, and the National Association of State Credit Union Supervisors.

Overview of the OIG's Strategic Plan 2011 – 2015

The following chart represents the structure of the OIG's strategic plan, which we updated to incorporate, among other things, new requirements under the Dodd-Frank Act, including our responsibilities as the OIG for the CFPB.

Mission

The Office of Inspector General (OIG) conducts independent and objective audits, inspections, evaluations, investigations, and other reviews related to the programs and operations of the Board of Governors of the Federal Reserve System (Board) and the Bureau of Consumer Financial Protection (Bureau). Through this work, the OIG promotes integrity, economy, efficiency, and effectiveness; helps prevent and detect fraud, waste, and abuse; and strengthens the agencies' accountability to Congress and the public.

Vision

The OIG promotes positive change, achieves results, fosters constructive working relationships with stakeholders, and protects the public interest through independent and risk-focused oversight of Board and Bureau programs and operations.

Values

Independence – Integrity – Excellence – Professionalism
Empowerment – Diversity – Public Interest

Goal 1

Enhance Economy, Efficiency, and Effectiveness; Limit Risk; Detect and Prevent Fraud and Abuse; and Ensure Compliance in the Federal Reserve Board's Programs and Operations

Objectives

1. Continue to oversee Board governance.
2. Review the Board's functions related to monetary policy and financial stability.
3. Assess the Board's responsibilities related to supervision and regulation.
4. Review the Board's oversight of the Federal Reserve Banks' operations.
5. Evaluate the Board's consumer and community affairs programs.
6. Conduct investigations of possible fraud, waste, abuse, and misconduct associated with Board programs and operations.

Goal 2

Enhance Economy, Efficiency, and Effectiveness; Limit Risk; Detect and Prevent Fraud and Abuse; and Ensure Compliance in the Bureau of Consumer Financial Protection's Programs and Operations

Objectives

1. Address current and emerging issues related to the governance, transfer of functions, and internal operations of the Bureau.
2. Review the Bureau's processes for formulating and issuing rules, orders, and guidance implementing federal consumer financial law.
3. Assess the Bureau's implementation of its supervision and enforcement activities.
4. Identify and review key aspects of the Bureau's role in establishing and implementing financial education programs for consumers of financial services and products.
5. Evaluate the Bureau's functions related to collecting data, researching trends, and tracking and publishing market information on consumer financial products and services.
6. Conduct work on the Bureau's approach to collecting, researching, and responding to consumer complaints.
7. Conduct investigations of possible fraud, waste, abuse, and misconduct associated with Bureau programs and operations.

Goal 3

Enhance the Efficiency and Effectiveness of the OIG's Operations and Communications

Objectives

1. Enhance human resources management.
2. Continue to enhance internal communications.
3. Further expand external communications.
4. Continue to improve our business processes.
5. Further strengthen our technology infrastructure.

Audits & Attestations
Financial/Performance Audits
Attestation Engagements

Inspections & Evaluations
Inspections/Program Evaluations
Best Practice Reviews

Investigations
Criminal/Civil/Administrative Cases

Legal Services
Counsel to Inspector General
Program/Project Legal Support
Congressional & Media Liaison
Legislative & Regulatory Review

Management & Quality Assurance (QA)
Semiannual and Other Reports
QA and Peer Review
Routine Activities
Internal Operations

Audits and Attestations

The Audits and Attestations program assesses aspects of the economy, efficiency, and effectiveness of Board and CFPB programs and operations. For example, Audits and Attestations conducts audits of (1) the Board's financial statements and financial performance reports; (2) the efficiency and effectiveness of processes and internal controls over agency programs and operations; (3) the adequacy of controls and security measures governing agency financial and management information systems and the safeguarding of assets and sensitive information; and (4) compliance with applicable laws and regulations related to agency financial, administrative, and program operations. As mandated by the IG Act, OIG audits and attestations are performed in accordance with the *Government Auditing Standards* established by the Comptroller General. The information below summarizes OIG work completed during the reporting period and ongoing work that will continue into the next semiannual reporting period.

COMPLETED AUDIT WORK AT THE BOARD

Audit of the Board's Financial Statements as of and for the Years Ended December 31, 2011 and 2010, and Audit of the FFIEC's Financial Statements as of and for the Years Ended December 31, 2011 and 2010

The OIG contracts with an independent public accounting firm to annually audit the financial statements of the Board and the FFIEC. (The Board performs the accounting function for the FFIEC.) The accounting firm, currently Deloitte & Touche LLP, performs the audits to obtain reasonable assurance that the financial statements are free of material misstatement. The OIG oversees the activities of the contractor to ensure compliance with generally accepted government auditing standards and Public Company Accounting Oversight Board auditing standards related to internal controls over financial reporting. The audits include examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The audits also include an assessment of the accounting principles used and significant estimates made by management, as well as an evaluation of the overall financial statement presentation.

In the auditors' opinion, the Board's and the FFIEC's financial statements presented fairly, in all material respects, the financial position, results of operations, and cash flows of each entity as of December 31, 2011 and 2010, in conformity with accounting principles generally accepted in the United States. To determine the auditing procedures necessary to express an opinion on the financial statements, the auditors reviewed the Board's and the FFIEC's internal control over financial reporting. For the third year, the auditors also expressed an opinion on the effectiveness of the Board's internal control over financial reporting based on the Public Company Accounting Oversight Board standards. In the auditors' opinion, the Board maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011. With regard to the FFIEC's internal control over financial reporting, the auditors noted no matters involving internal control over financial reporting that were considered material weaknesses in accordance with *Government Auditing Standards.*

As part of obtaining reasonable assurance that the financial statements are free of material misstatement, the auditors also performed tests of the Board's and the FFIEC's compliance with certain laws and regulations, since noncompliance with these provisions could have a direct and material effect on the determination of the financial statement amounts. The results of the auditors' tests disclosed no instances of noncompliance that would be required to be reported under *Government Auditing Standards.*

Audit of the Board's Information Security Program

During this reporting period, we completed our annual audit of the Board's Information Security Program and practices. The audit was performed pursuant to FISMA, which requires that each agency IG conduct an annual independent evaluation of the agency's Information Security Program and practices. Based on FISMA requirements, our specific audit objectives were to evaluate (1) the Board's compliance with FISMA and related information security policies, procedures, standards, and guidelines and (2) the effectiveness of security controls and techniques for a subset of the Board's information systems.

In accordance with Department of Homeland Security reporting requirements, our FISMA review included an analysis of the Board's information security–related processes in the following areas: risk management, continuous monitoring management, plans of action and milestones, identity and access management, remote access management, security configuration management, security training, contractor oversight, contingency planning, incident response and reporting, and security capital planning.

Overall, we found that the Board's Chief Information Officer (CIO) continued to maintain a FISMA-compliant approach to the Board's Information Security Program that is generally consistent with National Institute of Standards and Technology (NIST) and Office of Management and Budget (OMB) requirements. The Information Security Officer (ISO) continued to issue and update information security policies and guidelines. During 2011, the ISO developed an enterprise IT risk assessment framework initiative and a continuous monitoring strategy and began to implement a new automated workflow support tool that will provide an automated workflow method for documenting, reviewing, and approving the security posture of all Board information systems. In addition, the ISO took corrective actions in response to a number of open recommendations from our prior FISMA reports.

Although progress has been made by the ISO to address the new NIST guidance regarding risk management, the enterprise IT risk assessment framework needs to be fully implemented Boardwide and the automated workflow support tool needs to be fully operational for the Board to meet the requirements of NIST's organizationwide risk management approach. Our report contained a recommendation that the CIO complete and fully implement the enterprise IT risk assessment framework Boardwide and ensure that the automated workflow support tool is fully operational to comply with updated NIST guidance on the new Risk Management Framework.

In addition, our report included matters for management's consideration based on our analysis of the Board's contractor oversight and security capital planning programs. While not specifically required by NIST or OMB, the following actions could help strengthen the Board's information security posture: (1) under the Board's contractor oversight program, ensure that the Board's new automated workflow tool for managing the security posture of all Board information systems incorporates appropriate security management information for third-party systems operated by Federal Reserve Banks on behalf of the Board and (2) under the Board's security capital planning and investment program, to ensure adequate tracking of system security investments, enhance the Board's system development methodology by clarifying steps to account and budget for security over the system life cycle and analyze how security capital planning information at the system and enterprise levels can be integrated into the IT performance dashboard to provide a more comprehensive understanding of the business value and performance of the Board's information systems.

Upon review of open recommendations from our prior FISMA reports, we determined that sufficient action had been taken to close the recommendations from our 2010 FISMA report. To transform the Board's certification and accreditation process into the NIST Risk Management Framework and implement new NIST requirements for assessing security controls, our 2010 FISMA report included the following two recommendations to the CIO: (1) continue to develop and implement a Boardwide IT risk management strategy as required by NIST Special Publication 800-53, Revision 3, *Recommended Security Controls for Federal Information Systems and Organizations* (SP 800-53), Program Management family of controls and (2) as additional NIST and OMB guidance is issued and becomes effective, develop a continuous monitoring strategy and implement a continuous monitoring program as required by SP 800-53, Security Assessment and Authorization family of controls. Because the ISO developed and began implementing an enterprise IT risk assessment framework within the Division of Information Technology, we closed out the first recommendation. With the ISO issuing a continuous monitoring strategy and beginning the implementation of an expanded continuous monitoring program, we also closed the second recommendation.

Our 2010 FISMA report also included a recommendation that the CIO identify all IT services provided by organizations other than the Board and determine whether they need to be accredited as a third-party contractor system or as part of an existing general support system or major application. The CIO has taken sufficient actions to close this recommendation.

In addition, given the new NIST guidance regarding risk management that incorporates risk assessment, we closed a recommendation from our 2008 FISMA report that the CIO ensure that risk assessments are adequately identifying, evaluating, and documenting the level of risk to information systems based on potential threats, vulnerabilities, and currently implemented or planned controls, to determine whether additional controls are needed.

The Director of the Board's Division of Information Technology, in her capacity as the CIO, agreed with our 2011 recommendation that the CIO complete and fully implement the enterprise IT risk assessment framework Boardwide and ensure that the automated workflow support tool is fully operational for the Board to be compliant with updated NIST guidance on risk management. We will continue to monitor the ISO's actions in implementing the enterprise IT risk assessment framework Boardwide, which include improving overall risk assessments.

Security Control Review of the National Remote Access Services System

During this reporting period, we completed our security control review of the Federal Reserve System's National Remote Access Services (NRAS) system. The Board and the 12 Federal Reserve Banks use NRAS to remotely access Board and Federal Reserve Bank information systems. Our objectives were to evaluate the effectiveness of selected security controls and techniques to ensure that the Board maintains a remote access program that is generally compliant with FISMA requirements.

Overall, our review found that NRAS is technically and operationally sound and that the Board has developed an adequate process to administer the token keys for Board personnel. However, we identified opportunities to strengthen information security controls to help ensure that NRAS meets FISMA requirements.

In comments on a draft of our report, the Director of the Board's Division of Information Technology generally agreed with our recommendations and outlined corrective actions.

ONGOING AUDIT WORK AT THE BOARD

Audit of the Board's Government Travel Card Program

During this reporting period, we completed our fieldwork and began drafting the report for our review of the Board's government travel card program. The Board participates in the General Services Administration's SmartPay2 government travel card program. Our overall objective is to evaluate the effectiveness of the

Board’s controls over the travel card program. We are assessing whether controls (1) effectively provide reasonable assurance that cards are properly issued, administered, and controlled; (2) detect and prevent unauthorized or fraudulent transactions in a timely manner; and (3) adequately ensure proper use of the cards in accordance with Board policy and procedures. We expect to issue our final report during the next semiannual reporting period.

Audit of the Board’s Purchase Card Program

During this reporting period, we began a control review of the Board’s purchase card program. The program is part of a governmentwide charge card program administered by the General Services Administration to reduce the administrative cost of acquiring low-cost, standard items. The purchase card program streamlines business processes for certain government purchases as well as the processes for certifying and approving purchases. The Board adopted the use of purchase cards in 1995. The objective for this review is to determine whether controls are in place to prevent fraud and abuse. Specifically, we are evaluating the adequacy of procedures for issuing purchase cards and ensuring their proper use, and we are evaluating cardholders’ compliance with current Board policies. We expect to complete our review during the next semiannual reporting period.

Audit of the Board’s Internal Control Processes

During this reporting period, we completed our initial data-gathering and scoping effort of the internal control process of the Board’s Management Division. Based on our scoping work, we have begun an audit of the Board’s internal control processes across divisions. The objective of this audit is to assess the processes for establishing, maintaining, and monitoring internal control within the Board. A properly designed and effectively implemented internal control process should provide reasonable assurance that policies are followed and objectives are met; programs achieve their intended results; resource use is consistent with laws, regulations, and policies; and reliable information is obtained, maintained, reported, and used for decisionmaking. We expect to complete our review during the next semiannual reporting period.

Security Control Review of FISMA Assets Maintained by the Federal Reserve Bank of Richmond

We completed the fieldwork and issued a draft report on a security control review of two Lotus Notes applications listed on the Board’s FISMA inventory and maintained by the Federal Reserve Bank of Richmond. The two database applications are used by the Federal Reserve Bank of Richmond to support bank examinations. Our review objectives are to (1) evaluate the effectiveness of selected security controls and techniques for protecting the two Lotus Notes applications from unauthorized access, modification, or destruction and (2) assess compliance with the Board's Information Security Program. We plan to issue the final report in the next semiannual reporting period.

Audit of the Board's Continuity/Disaster Recovery Program for Its Information Systems

We completed the fieldwork and began drafting our report on the Board's continuity/disaster recovery program for its information systems. Our audit objective is to determine whether the Board is maintaining a program that is generally consistent with NIST and OMB FISMA guidance. To accomplish this objective, we developed a tailored control assessment program based on the Contingency Planning family of information security controls in NIST SP 800-53. We expect to complete our review during the next semiannual reporting period.

Security Control Review of the Office of Employee Benefits' Information Systems

We continued our fieldwork related to a security control review of information systems of the Federal Reserve System's Office of Employee Benefits (OEB). Our overall objective is to determine whether the OEB and its contractors are maintaining a program that is generally consistent with related NIST and OMB FISMA guidance. Our specific control review objective is to evaluate the adequacy of control techniques for protecting Board data in the information systems from unauthorized access, modification, destruction, or disclosure. We are using the Board's Information Security Program and related NIST FISMA guidance as criteria. We expect to complete our review during the next semiannual reporting period.

Security Control Review of the National Examination Database System

We began a security control review of the National Examination Database system. The National Examination Database system is listed as a major application on the Board's FISMA inventory for the Division of Banking Supervision and Regulation (BS&R). Our specific control review objective is to evaluate the adequacy of certain control techniques designed to protect data in the system from unauthorized access, modification, destruction, or disclosure. We will use the Board's Information Security Program, FISMA requirements, and applicable NIST guidelines as criteria.

Audit of the Board's Progress in Developing Enhanced Prudential Standards and Monitoring of Potential Systemic Risks

During this period, we issued for Board comment a draft management letter on BS&R's approach to developing enhanced prudential standards. We also drafted a report on the Board's actions to analyze potential risks related to mortgage foreclosures. The Dodd-Frank Act charged the Board with significant responsibilities, including the development of complex rulemakings, many in conjunction with other federal financial regulatory agencies. The act gave the Board important new authorities to support financial stability, including the responsibility for developing enhanced prudential standards for supervising large bank holding companies with total consolidated assets of $50 billion or more and systemically important nonbank financial companies designated by the Financial Stability Oversight Council (FSOC).

Our objectives are to assess (1) BS&R's approach to developing enhanced prudential standards for large bank holding companies, including standards that would apply to any nonbank financial company that FSOC designates as systemically important, and (2) the Board's activities in response to potential risks related to mortgage foreclosures. We expect to finalize and issue our management letter and audit report in the next reporting period.

Security Control Review of the Board's Public Website

We issued for Board comment a revised draft report on our security control review of the Board's public website (Pubweb). Pubweb is listed as a major application on the Board's FISMA inventory for the Office of Board Members. Pubweb provides the public with information about the mission and work of the Board. Our audit objectives are to evaluate the effectiveness of selected security controls and techniques for protecting Pubweb from unauthorized access, modification, or destruction and to ensure compliance with the Board's Information Security Program.

After the end of the reporting period, we received written comments from the Director of the Board's Division of Information Technology and the Assistant to the Board for the Office of Board Members, who stated that they generally agree with the recommendations in our report. We anticipate issuing our final report in the near future.

Multidisciplinary Work at the Board

Inquiry into Allegations of Undue Political Interference with Federal Reserve Officials Related to the 1972 Watergate Burglary and Iraq Weapons Purchases during the 1980s

In this reporting period, we issued our final report on our *Inquiry into Allegations of Undue Political Interference with Federal Reserve Officials Related to the 1972 Watergate Burglary and Iraq Weapons Purchases during the 1980s*. We initiated this inquiry in response to a request from the then Chairman of the House Committee on Financial Services to the Board for an investigation into allegations raised by a member of Congress, Representative Ron Paul, during the February 2010 Humphrey-Hawkins hearing before the committee, which the Board referred to our office.

We performed this inquiry to identify and assess any available evidence of undue political interference with Federal Reserve officials related to the 1972 Watergate burglary and Iraq weapons purchases during the 1980s. In assessing undue political interference, our review sought to identify any available evidence of the improper use of the political process or political authority that could have affected the conduct or decisionmaking of Federal Reserve officials. Based on our review of the February 2010 hearing record and discussions with the staffs of the then committee Chairman and Representative Paul, we focused our analysis on allegations that (1) the cash found on the Watergate burglars came through the Federal Reserve, (2) the Federal Reserve "stonewalled" congressional members and staff investigating the source of the cash found on the burglars, and (3) the Federal Reserve facilitated a $5.5 billion loan to Iraq for weapons purchases during the 1980s.

To identify any evidence regarding these matters, we searched voluminous Board and Federal Reserve Bank archives, as well as congressional records. We interviewed employees and examined documentation at the Board and on-site at the Federal Reserve Banks of Philadelphia, Atlanta, and New York. Additionally, we visited the Gerald R. Ford Presidential Library and Museum in Ann Arbor, Michigan, to review the library collection of Arthur Burns, Board Chairman at the time of the Watergate burglary. In conducting our inquiry, we also reviewed documents and reports written by the Federal Bureau of Investigation (FBI), the Government Accountability Office, and the Department of Justice.

We did not find any evidence of undue political interference with Federal Reserve officials related to the 1972 Watergate burglary or Iraq weapons purchases during the 1980s. Specifically, related to the Watergate allegations, we did not find any evidence of undue political interference with or improper actions by Federal Reserve officials related to the cash found on the Watergate burglars. We also did not find any evidence of undue political interference with Federal Reserve officials or inaccurate responses by Board officials regarding the allegation that the Federal Reserve officials "stonewalled" congressional members and staff regarding the source of the cash found on the burglars. With regard to the Iraq allegation, we did not find any evidence of undue political interference with Federal Reserve officials or any indications that the Federal Reserve facilitated a $5.5 billion loan to Saddam Hussein or Iraq for weapons purchases during the 1980s. We did not find evidence of any loans between the Federal Reserve and Saddam Hussein or Iraq during the 1980s.

In his comments on a draft of our report, the Board's General Counsel stated that our report confirmed past statements by Federal Reserve officials in relation to these incidents, and he indicated his appreciation for the thoroughness of our review. Our report did not contain any recommendations.

Inspections and Evaluations

The Inspections and Evaluations program encompasses OIG inspections, program evaluations, enterprise risk management activities, process design and life cycle evaluations, and legislatively mandated reviews of failed financial institutions that the Board supervises. Inspections are generally narrowly focused on a particular issue or topic and provide time-critical analysis that cuts across functions and organizations. In contrast, evaluations are generally focused on a specific program or function and make extensive use of statistical and quantitative analytical techniques. Evaluations can also encompass other preventive activities, such as reviews of system development life cycle projects and participation on task forces and workgroups. OIG inspections and evaluations are performed according to the *Quality Standards for Inspection and Evaluation* issued by the Council of the Inspectors General on Integrity and Efficiency (CIGIE).

COMPLETED INSPECTION AND EVALUATION WORK AT THE BOARD

Failed Bank Reviews

Section 38(k) of the FDI Act requires that the IG of the appropriate federal banking agency complete a review of the agency's supervision of a failed institution and issue a report within six months of notification from the FDIC IG when the projected loss to the DIF is material. Under section 38(k) of the FDI Act, as amended, a material loss to the DIF is defined as an estimated loss in excess of $200 million for losses that occurred from January 1, 2010, through December 31, 2011. For the period January 1, 2012, through December 31, 2013, a material loss to the DIF is defined as $150 million.

The material loss review provisions of section 38(k) require that the IG

- review the institution's supervision, including the agency's implementation of prompt corrective action (PCA)
- ascertain why the institution's problems resulted in a material loss to the DIF
- make recommendations for preventing any such loss in the future

The Dodd-Frank Act also establishes specific requirements for bank failures that result in losses below the materiality threshold. In these situations, the IG must review the failure to determine, among other things, whether the loss exhibits unusual circumstances that warrant an in-depth review. In such cases, the IG must prepare a report in a manner consistent with the requirements of a material loss review. Pursuant to the Dodd-Frank Act, the IG must semiannually report the dates when each such review and report will be completed. If the IG determines that a loss did not involve unusual circumstances, the IG is required to provide an explanation of its determination in the above-mentioned semiannual report. The OIG has included its report on nonmaterial loss bank failures in this *Semiannual Report to Congress* (see page 26).

As shown in the table below, during this reporting period we issued three reports on failed state member banks: two in which the loss to the DIF exceeded the materiality threshold, and one in which the loss did not meet the materiality threshold but presented unusual circumstances. These three banks had total assets of approximately $2.0 billion and total losses estimated at $653.9 million, or approximately 32.4 percent of total assets.

Failed Bank Reviews Completed during the Reporting Period

State Member Bank	Location	Federal Reserve Bank	Asset size (in millions)	DIF Projected Loss (in millions)	Closure Date	FDIC OIG Notification Date[a]
Legacy Bank[b]	Milwaukee, WI	Chicago	$225.1	$43.5	03/11/2011	N/A
The Park Avenue Bank	Valdosta, GA	Atlanta	$841.0	$326.1	04/29/2011	05/27/2011
First Chicago Bank and Trust	Chicago, IL	Chicago	$950.8	$284.3	07/08/2011	08/22/2011

a. Date that our office received notification from the FDIC IG that the projected loss to the DIF would be material.
b. Legacy Bank did not meet the materiality threshold; however, we determined that the bank's failure presented unusual circumstances that warranted an in-depth review.

Legacy Bank

Legacy Bank (Legacy) began operations in July 1999 as a de novo state member bank headquartered in Milwaukee, Wisconsin. Legacy was supervised by the Federal Reserve Bank of Chicago (FRB Chicago) under delegated authority from the Board, and by the State of Wisconsin Department of Financial Institutions (State). The State closed Legacy on March 11, 2011, and named the FDIC as receiver. According to the FDIC, the bank's total assets at closing were $225.1 million, and its failure resulted in an estimated $43.5 million loss to the DIF. While the loss is beneath the materiality threshold, we conducted an in-depth review after determining that Legacy's failure presented unusual circumstances: Examiners concluded that bank officers engaged in unsafe and unsound banking practices, and the bank received $5.5 million in funds from the Treasury's Capital Purchase Program under the Troubled Asset Relief Program (TARP).

Legacy failed because its board of directors and management did not adequately control the risks associated with the bank's aggressive growth strategy, which focused on lending in low- to moderate-income neighborhoods within the city of

Milwaukee. The bank was a community development financial institution that provided financial services to customers in an underserved community. Management depended on noncore funding sources to support the bank's growth strategy, which included providing loans to revitalize residential housing and commercial properties in distressed neighborhoods in Milwaukee. As a result, the bank developed a concentration in commercial real estate (CRE) loans and became vulnerable to a downturn in the local economy. The failure of Legacy's board of directors and management to implement risk management practices commensurate with the bank's increased risk profile, coupled with a weakening real estate market, led to rapid asset quality deterioration. Mounting losses eliminated the bank's earnings and depleted capital, which prompted the State to close Legacy and appoint the FDIC as receiver.

With respect to supervision, FRB Chicago complied with the examination frequency guidelines for the 2006–2011 time frame we reviewed, conducted regular off-site monitoring, and implemented the applicable PCA provisions. Our analysis of FRB Chicago's supervision of Legacy revealed that FRB Chicago identified the bank's fundamental weaknesses, including ineffective board of directors oversight, poor internal controls, and a high concentration in CRE loans, but did not take early, forceful supervisory action to address those weaknesses. Specifically, we believe that the findings noted during a March 2008 full-scope examination warranted stronger criticism, including CAMELS composite and component rating downgrades.[1] We also noted that FRB Chicago complied with the process outlined in Treasury's evaluation guidance when Legacy's holding company applied for TARP funds in October 2008.

We believe that Legacy's failure offers lessons learned that can be applied when supervising banks with similar characteristics. In our opinion, Legacy's failure demonstrated the importance of (1) examiners assuring that management implements credit risk management practices commensurate with the bank's strategy and risk profile, including CRE concentration levels, and (2) supervisors assigning CAMELS composite and component ratings consistent with the examination's findings and narrative examination comments.

The Director of BS&R concurred with our conclusions and lessons learned.

The Park Avenue Bank

The Park Avenue Bank (Park Avenue) was founded in 1956 in Valdosta, Georgia. In 1982, the bank established a parent holding company, PAB Bankshares, Inc. Park Avenue became a state member bank in 2001 and was supervised by the Federal Reserve Bank of Atlanta (FRB Atlanta), under delegated authority from

1. The CAMELS acronym represents six components: **c**apital adequacy, **a**sset quality, **m**anagement practices, **e**arnings performance, **l**iquidity position, and **s**ensitivity to market risk. Each component and overall composite score is assigned a rating of 1 through 5, with 1 indicating the least regulatory concern and 5, the greatest concern.

the Board, and by the State of Georgia Department of Banking and Finance (State). The State closed Park Avenue on April 29, 2011, and appointed the FDIC as receiver. The FDIC OIG notified our office that Park Avenue's failure would result in an estimated loss to the DIF of $326.1 million, or 39 percent of the bank's $841.0 million in total assets at closing. The FDIC subsequently revised its estimated loss to the DIF to exclude $20.0 million in debt issued by the holding company under the FDIC's Temporary Liquidity Guarantee Program.

Park Avenue failed because its board of directors and management did not adequately control the risks associated with the bank's growth strategy. The bank's strategy involved higher-risk CRE lending and expansion into new markets, which resulted in a concentration in construction, land, and land development (CLD) loans that made the bank particularly vulnerable to real estate market declines. The board of directors' and management's failure to establish credit risk management practices commensurate with the risks of CRE lending, coupled with high concentrations and weakening real estate markets, led to rapid asset quality deterioration. Mounting losses depleted earnings and eroded capital, which prompted the State to close Park Avenue and appoint the FDIC as receiver.

With respect to supervision, FRB Atlanta complied with the examination frequency guidelines for the time frame we reviewed, 2001 through 2011, and conducted regular off-site monitoring. However, our analysis revealed that Reserve Bank staff had opportunities to engage in more aggressive supervisory activities when signs of credit risk management weaknesses persisted. In our opinion, the bank's failure to establish basic credit administration practices in earlier years should have served as a warning sign for examiners that the bank lacked credit administration practices commensurate with the high risk in its loan portfolio, especially as its CRE and CLD concentrations increased. Supervisory criticisms of credit risk management diminished as asset quality ratios and earnings performance improved in 2003, despite continued weaknesses and few signs that credit risk management had improved in proportion with the heightened risk in the loan portfolio. Although Park Avenue did not appropriately identify, monitor, and limit the risk in its loan portfolio, examiners rated the bank satisfactory from 2003 through 2007 based, in part, on the bank's strong earnings and low level of classified assets. In our opinion, FRB Atlanta should have been more aggressive in its supervisory activities when signs of credit risk management weaknesses persisted, regardless of the bank's financial performance. Specifically, it should not have upgraded the bank's CAMELS composite rating in 2003 or terminated a 2003 board resolution before Park Avenue had clearly demonstrated that it had resolved its credit risk management deficiencies.

Further, we believe that FRB Atlanta should have held bank management accountable for not timely developing a CRE risk management program consistent with the guidance outlined in Supervision and Regulation Letter 07-01, *Interagency Guidance on Concentrations in Commercial Real Estate Lending,* *Sound Risk Management Practices* (SR Letter 07-01), especially given prior fundamental credit risk management weaknesses.

We believe that the lessons learned from Park Avenue's failure can be applied by those supervising banks with similar characteristics and circumstances. Park Avenue's failure illustrates (1) the risks associated with a strategic focus on high-risk loan products and expansion into new markets; (2) the importance of establishing appropriate credit risk management practices, including concentration limits and strong underwriting consistent with SR Letter 07-01 and the *Commercial Bank Examination Manual*, prior to pursuing higher-risk lending; and (3) the importance of scrutinizing any weaknesses in a function with previously noted deficiencies and implementing aggressive supervisory action to address those weaknesses.

The Director of BS&R concurred with our observations and lessons learned.

First Chicago Bank and Trust

First Chicago Bank and Trust (First Chicago) was created following the merger of Labe Bank and Bloomingdale Bank and Trust in November 2006. Labe Bank was a savings bank established in 1905 in Chicago, Illinois, and became a state member bank in 2006. Bloomingdale Bank and Trust was a state member bank established in 1991, and it operated in Bloomingdale, Illinois. First Chicago was supervised by FRB Chicago, under delegated authority from the Board, and by the Illinois Department of Financial and Professional Regulation (State). The State closed First Chicago on July 8, 2011, and appointed the FDIC as receiver. The FDIC OIG notified our office that First Chicago's failure would result in a $284.3 million loss to the DIF, or 29.9 percent of the bank's $950.8 million in total assets at closing.

First Chicago failed because its board of directors and management did not adequately control the risks associated with the bank's aggressive lending strategy, which focused on CRE loans, including CLD loans. The bank's business strategy included loan growth through CRE lending, supported primarily by noncore funding sources, and resulted in a CRE concentration. The 2006 merger that led to the creation of First Chicago reduced the bank's CRE concentration and helped diversify the bank's loan portfolio. Management planned to further reduce the bank's concentration through loan diversification by increasing lending in commercial and industrial loans. However, management's subsequent efforts failed to reduce and adequately manage the bank's credit concentration risks. First Chicago's CRE loan concentration, particularly in CLD loans, made the bank especially vulnerable to real estate market declines. First Chicago's board of directors' and management's failure to effectively manage the bank's CRE and CLD credit risk, coupled with a declining real estate market, led to significant asset quality deterioration. Mounting losses depleted the bank's earnings and eroded capital, which prompted the State to close First Chicago and appoint the FDIC as receiver on July 8, 2011.

With respect to supervision, FRB Chicago complied with the examination frequency guidelines for the 2007–2011 time frame we reviewed and conducted regular off-site monitoring. Our analysis of FRB Chicago's supervision of First Chicago revealed that FRB Chicago had a number of opportunities to deliver a stronger supervisory response. We believe a stronger supervisory response related to the credit risk management of concentrations was warranted as early as its April 2008 examination. In addition, while we recognize that FRB Chicago downgraded First Chicago's management CAMELS component rating in a June 2009 examination, we believe that an April 2009 supervisory assessment presented an opportunity for stronger criticism of management's performance related to the bank's deteriorating condition. Further, we believe that First Chicago's condition and management's inability to timely address identified deficiencies called for stronger criticism in a June 2010 examination, including a management component downgrade.

We believe that First Chicago's failure offers lessons learned that can be applied to supervising banks with similar characteristics and circumstances. First Chicago's failure illustrates the importance of (1) timely implementation of a robust credit risk assessment program designed to facilitate the identification and management of concentrations, (2) closely monitoring and assessing management performance, and (3) appropriately assigning management CAMELS ratings commensurate with the issues identified during the examination.

The Director of BS&R concurred with our conclusions and lessons learned.

Transfer of Office of Thrift Supervision Functions

Title III of the Dodd-Frank Act established provisions for the transfer of authority from the Office of Thrift Supervision (OTS) to the OCC, the FDIC, and the Board within one year after the July 21, 2010, date of the act's enactment. Under title III, the Board received the functions and rulemaking authority for consolidated supervision of savings and loan holding companies and their nondepository subsidiaries. This transfer of OTS functions to the Board was effective on July 21, 2011.

The Dodd-Frank Act required that, within 180 days after its enactment, the OTS, the OCC, the FDIC, and the Board jointly submit a plan (Joint Implementation Plan) to Congress and the IGs of Treasury, the FDIC, and the Board that detailed the steps each agency would take to implement the title III provisions. The Joint Implementation Plan was submitted to Congress and the IGs on January 25, 2011. The Dodd-Frank Act required that the IGs conduct a review to determine whether the implementation plan conformed to the title III provisions. On March 28, 2011, the IGs jointly issued a report concluding that the actions described in the Joint Implementation Plan generally conformed to the provisions of title III.[2]

Section 327 of title III requires the IGs to report on the status of the implementation of the Joint Implementation Plan every six months. The IGs have submitted two status reports to date: one on September 28, 2011, and the other on March 28, 2012. These joint reports, both titled *Status of the Transfer of Office of Thrift Supervision Functions,* concluded that the Board, the FDIC, the OCC, and the OTS have substantially implemented the actions in the plan to transfer OTS functions, employees, funds, and property to the Board, the FDIC, and the OCC, as appropriate. However, both reports noted that the Board was still undertaking certain aspects of the plan, and the first report noted that certain other aspects were not yet required to be completed as provided in title III.

In its written comments regarding the March 28, 2012, report, the Board stated that it agreed with the IGs' conclusion.

Review of the Division of Reserve Bank Operations and Payment Systems' Oversight of the Next Generation $100 Note

During this reporting period, we completed a review of the Division of Reserve Bank Operations and Payment Systems' (RBOPS's) oversight of the next generation (NXG) $100 note. The Board is the sole issuer of U.S. currency, and RBOPS (on behalf of the Board) is responsible for ensuring the high quality of the Federal Reserve notes that are printed by Treasury's Bureau of Engraving and Printing (BEP). The NXG $100 note is the final denomination to be redesigned in the NXG currency redesign project that began in 2000, and it includes the most complex anticounterfeiting security features ever incorporated into U.S. currency. We began this review as a result of the Board's October 1, 2010, press release announcing that it would delay issuing the NXG $100 note due to the increasing incidence of currency paper creasing during the printing process. Our review objectives were to (1) assess RBOPS' oversight of the design and production of the NXG $100 notes; (2) review the actions RBOPS has taken to address the printing problems, which included contracting for an independent technical review, and to enhance controls to minimize the likelihood of future printing problems; and (3) assess plans for the disposition of NXG $100 notes that have already been printed.

Our analysis determined that actions taken by RBOPS appropriately addressed the identified printing issues and enhanced controls to minimize the likelihood of future printing problems. In addition, we determined that RBOPS staff is participating in the assessment of plans for the disposition of the more than 1.4 billion NXG $100 notes that have been printed. We identified three areas,

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2. However, in response to a finding in the joint IGs' report, the Joint Implementation Plan was amended in April 2011 to expand on the protections for transferred OTS employees.

however, in which RBOPS could strengthen oversight of the Federal Reserve note design and quality control production process:

- RBOPS staff should comply with requirements in a memorandum of understanding (MOU) that details the authorities, responsibilities, and understandings between RBOPS and the BEP, to include agreeing on a limited initial production quantity of newly designed currency.

- The Interagency Currency Design workgroup, which provides technical guidance on currency design and other subjects that affect U.S. currency, should operate under an executed charter.

- The current MOU between the Board and the BEP should be updated and expanded to incorporate the increased complexity of note design, quality control, and production.

Our report contained recommendations to address the absence of (1) an approved and signed Interagency Currency Design workgroup charter and (2) an updated MOU that incorporates increased design complexities. We did not make a recommendation regarding compliance with requirements in the MOU because the Board and the BEP entered into a NXG $100 note production validation agreement in September 2011 to ensure that all technical problems are identified and resolved prior to restarting full production.

The Director of RBOPS agreed with our recommendations and specified actions that have been or will be taken to implement them.

ONGOING INSPECTION AND EVALUATION WORK AT THE BOARD

Failed Bank Reviews

As discussed below, we are currently conducting three failed bank reviews. These banks had total assets of approximately $2.8 billion and total losses to the DIF estimated at $628.0 million, or approximately 22.4 percent of total assets.

Bank of the Commonwealth

On September 23, 2011, the Commonwealth of Virginia State Corporation Commission, Bureau of Financial Institutions, closed Bank of the Commonwealth, headquartered in Norfolk, Virginia. At closure, the FDIC reported that Bank of the Commonwealth had approximately $974.9 million in total assets. On October 12, 2011, the FDIC OIG notified our office that the FDIC had estimated a $268.3 million loss to the DIF, which exceeds the statutory threshold requiring us to conduct a material loss review. As such, we initiated a material loss review, and we plan to issue our report by April 12, 2012.

Community Banks of Colorado

On October 21, 2011, the Board appointed the FDIC as receiver for Community Banks of Colorado, located in Greenwood Village, Colorado. At the closure, the FDIC reported that Community Banks of Colorado had $1.3 billion in total assets. On November 18, 2011, the FDIC OIG notified our office that the FDIC had estimated a $224.9 million loss to the DIF, which exceed the statutory threshold requiring us to conduct a material loss review. As such, we initiated a material loss review, and we plan to issue our report by May 18, 2012.

Bank of Whitman

On August 5, 2011, the Washington Department of Financial Institutions closed Bank of Whitman, headquartered in Colfax, Washington. At closure, the FDIC reported that Bank of Whitman had $548.6 million in total assets as of June 30, 2011. On August 5, 2011, the FDIC estimated that the cost of the failure to the DIF would be $134.8 million, which did not meet the materiality threshold as defined under section 38(k) of the FDI Act. However, we determined that Bank of Whitman's failure presents unusual circumstances warranting an in-depth review because, among other factors, (1) senior bank officials allegedly colluded with other banks in a scheme designed to increase capital and (2) a borrower with whom Bank of Whitman had a substantial relationship was allegedly involved in a Ponzi scheme that may have involved the use of bank funds. Bank of Whitman was cited for several violations of Washington's legal lending limit, including loans made to this borrower. We expect to issue our report by September 2012.

2012 Audit Survey of Board and CFPB Controls over Sensitive and Proprietary Information Collected and Exchanged with FSOC

The Dodd-Frank Act created FSOC and CIGFO. FSOC is charged with identifying threats to the financial stability of the country, promoting market discipline, and responding to emerging risks to the stability of the nation's financial system.[3] As such, FSOC collects and manages sensitive information that must be properly safeguarded against unauthorized disclosure. CIGFO, which comprises nine IGs of federal financial regulatory entities, was established to facilitate information sharing among its IG members; provide a forum for discussion of IG member work as it relates to the broader financial sector; and, by

3. Voting FSOC members include the Secretary of the Treasury, the Chairman of the Board, the Comptroller of the Currency, the Director of the CFPB, the Chairman of the SEC, the Chairperson of FDIC, the Chairperson of the CFTC, the Director of the FHFA, the Chairman of the NCUA Board, and an independent member with insurance expertise. Nonvoting FSOC members include the Director of the Office of Financial Research, the Director of the Federal Insurance Office, a state insurance commissioner, a state banking supervisor, and a state securities commissioner. The entities covered within the scope of this audit consist of FSOC, the Office of Financial Research, the Federal Insurance Office, and FSOC member agencies with voting rights.

a majority vote, convene a Working Group to evaluate the effectiveness and internal operations of FSOC.

This audit survey is examining the controls and protocols that FSOC and its member agencies have implemented to properly safeguard sensitive FSOC-related information. As our part in accomplishing this objective, we will determine the controls and protocols that have been established by the Board and the CFPB to manage sensitive and proprietary FSOC-related information. CIGFO will prepare a consolidated report containing the results of the respective IG members.

Review of the Unauthorized Disclosure of a "Confidential Staff Draft" of the Volcker Rule Notice of Proposed Rulemaking

On October 11, 2011, the Board, the FDIC, and the OCC issued press releases requesting public comment on a notice of proposed rulemaking implementing the requirements of section 619 of the Dodd-Frank Act.[4] Section 619, which amends the Bank Holding Company Act of 1956 (12 U.S.C. § 1841 et seq.), contains two key prohibitions on the activities of insured depository institutions, bank holding companies, and their subsidiaries or affiliates.[5] The first prohibition precludes banking entities from engaging in short-term proprietary trading of any security, derivative, and certain other financial instruments for a banking entity's own account.[6] The second prohibition precludes banking entities from owning, sponsoring, or having certain relationships with a hedge fund or private equity fund.[7] These two prohibitions are commonly referred to as the "Volcker Rule."[8] The notice of proposed rulemaking to implement the Volcker Rule (referred to hereafter as the NPRM) has attracted considerable attention because the two prohibitions require adjustments to the business models of large, complex banking organizations.

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4. Section 619 of the Dodd-Frank Act appears in Pub. L. No. 111-203, 124 Stat. 1620-31, and is codified at 12 U.S.C. § 1851. The October 11, 2011, version of the notice of proposed rulemaking (NPRM) had not been paginated or formatted for purposes of the *Federal Register*. The NPRM, "Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds," appeared in the November 7, 2011, *Federal Register*. 76 Fed. Reg. 68846 (Nov. 7, 2011).

5. Section 619 amends the Bank Holding Company Act of 1956 by adding a new section 13, "Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds."

6. Proprietary trading refers to trading in stocks or other financial instruments using the institution's own funds to profit from short-term price changes.

7. Hedge funds refer to investment vehicles that engage in active trading of securities and other financial contracts. Private equity funds generally refer to funds that use leverage or other methods to invest in companies or other less liquid investments.

8. Former Board Chairman Paul Volcker, while serving as the Chairman of the President's Economic Recovery Advisory Board, opined that the riskier trading activities of commercial banks and their affiliates contributed to the recent financial crisis. The "Volcker Rule" generally refers to separating commercial banking from riskier activities such as proprietary trading and operating a hedge fund or engaging in private equity activities.

Section 619 required the Board, the FDIC, the OCC, the SEC, and the CFTC (collectively, the Agencies) to jointly adopt rules to implement its provisions. As part of this joint rulemaking process, Board employees involved in the rulemaking distributed several versions of the NPRM to the Agencies for deliberation, including a "confidential staff draft" dated September 30, 2011. On October 5, 2011, *American Banker*, a banking and financial services media outlet, published this nonpublic, confidential staff draft of the NPRM on its website. We are conducting this review to evaluate whether Board and/or Federal Reserve Bank of New York staff had knowledge of, or played a role in, the unauthorized disclosure of the confidential staff draft of the NPRM and to assess the Board's information-sharing practices for rulemaking activities. We plan to issue our report during the next semiannual reporting period.

Inspection of the Board's Protective Services Unit

During this semiannual reporting period, we completed fieldwork and began drafting our report on an inspection of the Board's Protective Services Unit, the organization that ensures the physical security of the Chairman of the Board of Governors of the Federal Reserve System. The USA Patriot Act of 2001 granted the Board certain federal law enforcement authorities, and the regulations implementing this authority designated the OIG as the external oversight function for the Board's law enforcement programs. We are performing this inspection to fulfill our external oversight function responsibility. The objective of this inspection is to provide reasonable assurance that the Protective Services Unit's operations comply with applicable laws, regulations, policies, and procedures and align with law enforcement best practices.

Congressional Request Regarding the Examination Process for Small Community Banks

During this reporting period, we received a letter from the Chairman of the Senate Committee on Banking, Housing, and Urban Affairs requesting that we audit the Board's examination process for small community banks. Based on the Chairman's request, we plan to review (1) the Board's examination timelines and how the Board ensures consistency in the administration of examinations throughout the Federal Reserve System, (2) the ability of Board-regulated institutions to question examination results through the Board's Ombudsman program or other appeals process, and (3) the frequency and results of examination appeals. We have begun our fieldwork to fulfill this request and plan to complete the audit during the next semiannual reporting period.

Evaluation of the Board's Emergency Preparedness for Unexpected Emergency Events

During this reporting period, we initiated an evaluation of the Board's emergency preparedness. The objective of this review is to evaluate the Board's policies and procedures for responding to unexpected emergency events. As part of this effort, we will assess the law enforcement unit's communication protocols for processing and disseminating information to Board staff during such events. We plan to complete this evaluation in late 2012.

Information on Nonmaterial Losses to the Deposit Insurance Fund, as Required by the Dodd-Frank Act

The FDI Act, as amended by the Dodd-Frank Act, requires the IG of the appropriate federal banking agency to report, on a semiannual basis, certain information on financial institutions that incurred nonmaterial losses to the DIF and that failed during the respective six-month period. As shown in the table below, one failed state member bank had a loss to the DIF that did not meet the materiality threshold requiring an OIG review, which currently is a loss in excess of $150.0 million. This institution had total assets of approximately $256.6 million and losses estimated at $75.6 million, or 29.5 percent of total assets.

When bank failures result in nonmaterial losses to the DIF, the IG is required to determine (1) the grounds identified by the federal banking agency or the state bank supervisor for appointing the FDIC as receiver[9] and (2) whether the losses to the DIF present unusual circumstances that would warrant an in-depth review. If no unusual circumstances are identified, the IG is required to provide an explanation of its determination.

We reviewed the state member bank failure to determine whether the resulting loss to the DIF exhibited unusual circumstances that would warrant an in-depth review. In general, we considered a loss to the DIF to present unusual circumstances if the conditions associated with the bank's deterioration, ultimate closure, and supervision were not addressed in any of our prior bank failure reports or involved potential fraudulent activity. To make this determination, we analyzed key data from the five-year period preceding the bank's closure. These data generally comprised Federal Reserve Bank and state examination schedules; Reports of Examination, including CAMELS ratings and financial data; informal and formal enforcement actions and other supervisory activities, such as visitations; and PCA determinations. As shown in the below table, we determined that the state member bank failure did not exhibit unusual circumstances warranting an in-depth review.

Nonmaterial State Member Bank Failures during the Reporting Period

State Member Bank	Location	Asset size (millions)	DIF Projected Loss (millions)	Closure Date	OIG Summary of State's Grounds for Receivership	OIG Determination
BankEast	Knoxville, TN	$256.6	$75.6	01/27/2012	Unsound condition	No unusual circumstances noted

9. Typically, the state closes state member banks and appoints the FDIC as receiver.

Consumer Financial Protection Bureau

The Dodd-Frank Act established the CFPB as an independent entity within the Federal Reserve System and designated our office as the CFPB's OIG. The CFPB's statutory purpose is to implement and, as applicable, consistently enforce federal consumer financial law to ensure that all consumers have access to markets for financial products and services and that these markets are fair, transparent, and competitive. On July 21, 2011, certain authorities transferred from other agencies to the CFPB. The following are highlights of our CFPB-related oversight activities during the last six months.

COMPLETED WORK

Audit of the CFPB's Information Security Program

During this reporting period, we completed our initial audit of the CFPB's Information Security Program and practices. The audit was performed pursuant to FISMA, which requires that each agency IG conduct an annual independent evaluation of the agency's Information Security Program and practices.

The CFPB is relying on the Information Security Program and computer systems of Treasury. As part of its 2011 FISMA audit, the Treasury OIG evaluated the effectiveness of Treasury's Information Security Programs, including controls for 15 systems across Treasury bureaus. One of the systems included in the Treasury OIG's FISMA review was a general support system that the CFPB is relying on for network infrastructure and connectivity to support a number of applications. To meet our annual FISMA reporting responsibilities for the CFPB and avoid duplication of effort, we relied on the FISMA work performed by the Treasury OIG.

The Treasury OIG contracted with KPMG LLC, an independent certified public accounting firm, to perform its 2011 FISMA audit. Overall, KPMG concluded that Treasury's Information Security Program and practices for its non-Internal Revenue Service bureaus' unclassified systems were generally consistent with the requirements of FISMA. KPMG noted, however, that "Treasury's Information Security Program was not fully effective," as evidenced by control weaknesses identified for various Treasury systems. Treasury can improve the effectiveness of its Information Security Program and controls for the general support system that CFPB relies on by strengthening risk management, configuration management, and contingency planning controls.

In comments on a draft of our report, the CFPB CIO stated that the CFPB continues to leverage certain services provided by Treasury as an interim means to maintain operational efficiencies. The CIO also noted that a key component of CFPB technology independence is a robust and comprehensive cyber-security program. The CFPB's cyber security program is aligned to the risk management framework developed by NIST. As a newly established agency, the CFPB is working steadily to develop and mature its internal functions and processes, including the many facets of technology management.

ONGOING WORK

Evaluation of the CFPB's Contract Solicitation and Selection Process

The CFPB established a procurement function and has been contracting for goods and services. Accordingly, we are conducting an evaluation of certain aspects of the CFPB's contracting process. The evaluation objective is to determine whether the CFPB's contract solicitation and selection processes and practices are compliant with applicable rules established by the Federal Acquisition Regulation. During this reporting period, we initiated fieldwork and began assessing the CFPB's contracting activities.

Evaluation of the CFPB's Consumer Response Center

As of March 5, 2012, the CFPB's Consumer Response Center is accepting complaints regarding credit cards, mortgages, checking accounts, and private student loans through its website and toll-free number. As part of our office's oversight responsibilities, we are assessing several of the Consumer Response Center's processes. Our objectives are to (1) evaluate the process the CFPB has established to receive, track, and respond to consumer complaints; (2) assess the CFPB's coordination with federal and state regulatory agencies regarding the processing and referral of complaints; and (3) determine the extent to which the CFPB is assessing its performance when responding to consumer complaints.

Evaluation of the CFPB's Annual Budget Process

During this reporting period, we initiated an evaluation of the CFPB's annual budget process. As an independent agency within the Federal Reserve System, the CFPB is funded principally by the Federal Reserve System in amounts determined by the CFPB Director as necessary to carry out the agency's operations, subject to limits established in the Dodd-Frank Act. These transferred funds are not subject to the congressional appropriations process. The CFPB prepared and publicly issued budget documents for fiscal years 2012 and 2013. In the CFPB's 2013 budget justification issued in February 2012, the agency estimated budgeted expenses of $356 million in fiscal year 2012 and $448 million in fiscal year 2013. We are currently performing an initial scoping effort to establish the specific objectives, scope, and methodology for this evaluation.

2012 Audit Survey of Board and CFPB Controls over Sensitive and Proprietary Information Collected and Exchanged with the FSOC

(See page 22 for a description of this audit survey.)

Investigations

The OIG's Investigations office conducts criminal, civil, and administrative investigations related to Board and CFPB programs and operations. The OIG operates under statutory law enforcement authority granted by the U.S. Attorney General, which vests our special agents with the authority to carry firearms, make arrests without a warrant, seek and execute search and arrest warrants, and seize evidence. Our special agents engage in joint task force and other criminal investigations involving matters such as bank fraud, mortgage fraud, money laundering, and other financially related crimes impacting Board- and CFPB-regulated financial institutions. OIG investigations are conducted in compliance with CIGIE's *Quality Standards for Investigations*.

INVESTIGATIVE ACTIVITIES

During this reporting period, we opened 8 cases, closed 3 cases, and ended the period with 43 investigations in progress. Due to the sensitivity of these investigations, we only report on concluded and ongoing activities that have resulted in criminal, civil, or administrative action. The following summaries highlight our significant investigative activity during this semiannual reporting period.

Former President and Chief Executive Officer of Orion Bank Pleads Guilty to Bank Fraud Charges

On February 3, 2012, the president and chief executive officer of Orion Bank, Naples, Florida, entered a guilty plea to a criminal information in which he was charged with conspiring to commit bank fraud, misapplying bank funds, making false entries in the bank's books and records, and obstructing a bank examination. The charges relate to his role in a scheme to lend $82 million to "straw" borrowers acting on behalf of an Orion Bank borrower (hereafter referred to as the initial borrower) who had reached the bank's legal lending limit. Additionally, the loans concealed $15 million in bank funds to be used for the purchase of Orion stock by the initial borrower, in violation of banking laws and regulations. Orion Bank proceeded to fund the loan transactions even though bank executives, including the president, became aware prior to loan closing that the initial borrower's entire loan relationship was based on fraudulent financial documents.

In 2009, Orion Bank was in danger of being declared *critically undercapitalized* by the Board. The president indicated that the bank was in the process of raising $75 million in additional capital. After unsuccessful attempts to raise capital conventionally, he and the other co-conspirators developed a scheme to increase loans in process to the initial borrower and another borrower to provide financing for the purchase of bank stock. The president took this action despite knowing that such loans were prohibited by banking laws and regulations. He directed that $82 million in additional loans be made to straw borrowers acting for the initial borrower. He directed Orion Bank staff to continue with the loans to the initial borrower, despite learning prior to closing the loans that the initial borrower's entire relationship with the bank, which was in excess of $40 million, was based on fraudulent financial documents. Based on agreements with the president, the initial borrower purchased $15 million of Orion Bancorp, Inc. stock, and the second borrower purchased $10 million in stock, in violation of banking laws and regulations. Following the illegal stock transactions, the president repeatedly lied to the bank's regulators regarding the source of the capital infusion. During the course of the scheme, the president also sold more than $750,000 of his personal bank stock to other investors under false pretenses.

The president is scheduled to be sentenced on May 15, 2012, and is facing a maximum of 15 years in prison. In addition, two senior loan officers are currently serving 24 and 30 months, respectively, for their roles in the conspiracy and were ordered to jointly and severally pay $33,512,618 in restitution. Additionally, the initial borrower is currently serving 65 months in prison and was ordered to pay $65,214,419 in restitution.

This was a joint investigation by the FBI, the Internal Revenue Service–Criminal Investigation, the FDIC OIG, SIGTARP, and the Board's OIG. The case was prosecuted by the U.S. Attorney's Office for the Middle District of Florida.

Two Former Officials of United Commercial Bank Indicted on Securities Fraud Charges and Guilty Plea Entered by a Former Employee

On September 15, 2011, a former executive vice president and a former senior vice president of United Commercial Bank (UCB) were indicted on charges of conspiracy to commit securities fraud, security fraud, falsifying corporate books and records, and lying to auditors. In addition, on October 13, 2011, the guilty plea of a former UCB employee who admitted to charges of conspiracy to commit securities fraud was unsealed. UCB was a subsidiary of United Commercial Bank Holdings, Inc., which was a Board-regulated holding company whose shares were registered with the SEC and were traded on the Nasdaq. The OIG initiated this investigation at the request of the FBI and the U.S. Attorney's Office for the Northern District of California.

According to the indictment, from 2004 through 2007, UCB's loan portfolio increased from approximately $4.4 billion to more than $8.0 billion. By September 2008, the bank's portfolio faced growing losses. The indictment alleges that, beginning in approximately September 2008, the former executive vice president and the former senior vice president participated in a fraudulent scheme to hide the bank's true financial condition from the regulators, independent auditors, investors, and depositors.

In May 2009, UCB announced that the financial statements contained in its March 16, 2009, SEC Form 10-K were unreliable and that UCB intended to restate them. However, prior to the restatement of the financial statements, UCB failed in November 2009, and the FDIC was appointed the receiver. The indictment states that the FDIC paid out approximately $397 million and estimates total losses to the FDIC will be approximately $2.5 billion. In addition, the indictment reported that UCB received $298 million in TARP funds in November 2008. To date, none of the TARP funds have been repaid.

The indictment charges that the defendants and others caused the bank to issue materially false and misleading public statements and reports regarding its year-end financial condition and performance in, among other things, a January 22, 2009, press release; an earnings call held on January 23, 2009; and an annual report (SEC Form 10-K) filed on March 16, 2009.

This investigation is being worked jointly by the FBI, SIGTARP, the FDIC OIG, and the Board's OIG.

Twelve Individuals Arrested in Connection with Money Laundering Case

The OIG initiated this investigation based on a request from the U.S. Attorney's Office for the District of South Carolina. The OIG's investigation revealed that several individuals were engaged in money laundering and bank fraud at Federal Reserve–regulated institutions. The investigation also revealed that these individuals were operating unregistered money service businesses; a trucking company; and convenience stores in the Charleston, South Carolina, metro area. The individuals fraudulently obtained and misused social security numbers, utilized business and personal financial accounts to send and receive domestic and overseas wires, utilized unregistered money service businesses to wire an undetermined amount of U.S. currency via Western Union to domestic and international accounts, structured deposits with multiple financial institutions, and made numerous false statements on various federal and state documents.

In June 2011, the OIG's investigation was merged with an ongoing Bureau of Alcohol, Tobacco, Firearms, and Explosives investigation involving illegal cigarette sales. On December 5, 2011, 12 individuals were arrested in a money laundering and a cigarette trafficking scheme spanning several states. These 12 individuals were simultaneously arrested in North Carolina, South Carolina, and New York. Concurrent with the arrests, several search warrants were also executed, resulting in the seizure of approximately $1.5 million in cash, 29 vehicles, and several businesses and residences.

This is a joint investigation by the Bureau of Alcohol, Tobacco, Firearms, and Explosives; the Internal Revenue Service–Criminal Investigation; the U.S. Diplomatic Security Service; the Charlotte Mecklenburg Police Department; the Treasury OIG; and the Board's OIG.

Individual Sentenced in Maryland Mortgage Fraud Task Force Investigation

As part of the Maryland Mortgage Fraud Task Force, the OIG initiated an investigation of an alleged mortgage fraud scheme. The investigation disclosed that between June and September 2007, three subjects conspired to commit a mortgage fraud scheme that netted more than $1.2 million from three federally regulated financial institutions. Specifically, the subjects submitted false mortgage applications for three properties that included false certifications of occupancy and inflated income. Each of the properties went into foreclosure or short sale, resulting in a total loss to the banks of $859,191.

On March 12, 2012, a Maryland woman was sentenced to six months of incarceration to be followed by three years of supervised release, with the first six months to be served under home detention, for conspiracy to commit wire fraud. This subject was ordered to jointly and severally pay restitution of $859,191 with two other previously sentenced subjects until the debt is satisfied.

This was a joint investigation by the FBI and the Board's OIG. The case was prosecuted by the U.S. Attorney's Office for the District of Maryland, Southern Division.

INVESTIGATIVE STATISTICS

Summary Statistics on Investigations during the Reporting Period[a]

Investigative Actions	Number
Investigative Caseload	
Investigations Open at End of Previous Reporting Period	38
Investigations Opened during Reporting Period	8
Investigations Closed during Reporting Period	3
Total Investigations Open at End of Reporting Period	43
Investigative Results for Reporting Period	
Referred to Prosecutor	8
Joint Investigations	39
Referred for Audit	0
Referred for Administrative Action	1
Oral and/or Written Reprimands	0
Terminations of Employment	0
Arrests	15
Suspensions	0
Debarments	0
Indictments	14
Criminal Information	1
Convictions	2
Monetary Recoveries	$0
Civil Actions (Fines and Restitution)	$0
Criminal Fines, Restitution, and Forfeitures	$66,074,082

a. Some of the investigative numbers may include data also captured by other OIGs.

HOTLINE ACTIVITIES

To report fraud, waste, abuse, or mismanagement related to the programs or operations of the Board or the CFPB, individuals may contact the OIG Hotline by mail, telephone, fax, or e-mail. Hotline staff analyzes all incoming complaints and, as appropriate, coordinates with OIG and/or other federal staff. During this reporting period, the Hotline received 280 complaints, a 55 percent increase from the previous reporting period.

The OIG Hotline received an increasing number of complaints from individuals seeking information about or wanting to file non-criminal consumer complaints against financial institutions. Hotline staff analyzes these complaints and typically refers the complainant to the consumer group of the appropriate federal regulator for the institution involved, such as the Federal Reserve Consumer Help unit or the Customer Assistance Group of the OCC. Beginning in July 2011, the CFPB's Consumer Response group began accepting credit card complaints from consumers. Since then, the group has expanded to accept complaints about mortgages and other bank products and services. As appropriate, Hotline staff refers individuals to the CFPB's Consumer Response group for assistance.

The OIG Hotline continued to receive a significant number of complaints involving suspicious solicitations invoking the Federal Reserve name. During this reporting period, the OIG Hotline posted information on its public website to educate people about spam e-mails claiming to be from the Federal Reserve. We have received positive feedback from individuals regarding this posting. Hotline staff continues to advise all individuals that these spam e-mails are solicitations that attempt to obtain the personal and/or financial information of the recipient and that neither the Board nor the Federal Reserve Banks endorse or have any involvement in them. As appropriate, the OIG may investigate these complaints.

During this reporting period, Hotline staff began presenting information about the OIG and its Hotline to new employees of the Board and the CFPB at the agencies' new employee orientations. Hotline staff will continue these presentations to promote the mission and values of the OIG.

HOTLINE STATISTICS

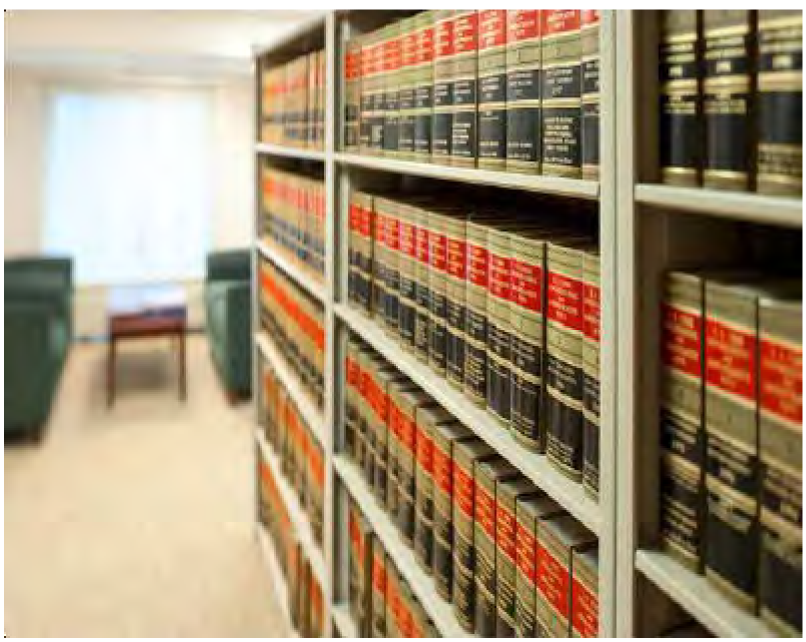
Summary Statistics on Hotline Activities during the Reporting Period

Hotline Complaints	Number
Complaints Pending from Previous Reporting Period	2
Complaints Received during Reporting Period	280
Total Complaints for Reporting Period	282
Complaints Resolved during Reporting Period	274
Complaints Pending	8

Legal Services

The Legal Services program serves as the independent legal counsel to the IG and the OIG staff. The Legal Services staff provides comprehensive legal advice, research, counseling, analysis, and representation in support of OIG audits, investigations, inspections, evaluations, and other professional, management, and administrative functions. This work provides the legal basis for the conclusions, findings, and recommendations contained within OIG reports. Moreover, Legal Services keeps the IG and the OIG staff aware of recent legal developments that may affect the activities of the OIG, the Board, and the CFPB.

In accordance with section 4(a)(2) of the IG Act, the Legal Services staff conducts an independent review of newly enacted and proposed legislation and regulations to determine their potential effect on the economy and efficiency of the Board's and the CFPB's programs and operations. During this reporting period, Legal Services reviewed 22 legislative and 11 regulatory items.



Communications and Coordination

While the OIG's primary mission is to enhance the economy, efficiency, and effectiveness of Board and CFPB programs and operations, we also coordinate externally and work internally to achieve our goals and objectives. Externally, we regularly coordinate with and provide information to Congress and congressional staff. We also are active members of the broader IG professional community and promote collaboration on shared concerns. Internally, we consistently strive to enhance and maximize efficiency and transparency in our infrastructure and day-to-day operations. Within the Board, the CFPB, and the Federal Reserve System, we continue to provide information about the OIG's roles and responsibilities. In addition, we participate in an advisory capacity on various Board work groups. Highlights of these activities follow.

Congressional Coordination and Testimony

The OIG communicates and coordinates with various congressional committees on issues of mutual interest. During the reporting period, we provided 23 responses to congressional members and staff concerning the Board and the CFPB.

Council of Inspectors General on Financial Oversight

Consistent with the Dodd-Frank Act, CIGFO is required to meet at least quarterly to facilitate the sharing of information among the IGs and to discuss the ongoing work of each IG, with a focus on concerns that may apply to the broader financial sector and ways to improve financial oversight. During this reporting period, CIGFO met on December 8, 2011, and March 30, 2012. The Treasury IG chairs CIGFO. The Dodd-Frank Act authorizes CIGFO, by a majority vote, to convene a Working Group to evaluate the effectiveness and internal operations of FSOC. As discussed on page 22, we are currently working on an audit survey examining the controls and protocols that FSOC and its member agencies have implemented to properly safeguard sensitive FSOC-related information. To accomplish this objective, we will determine the controls and protocols that have been established by the Board and the CFPB to manage sensitive and proprietary FSOC-related information. CIGFO will prepare a consolidated report containing the results of the respective IG members.

In addition, CIGFO is required to annually issue a report that highlights the IGs' concerns and recommendations, as well as issues that may apply to the broader financial sector. CIGFO issued its first annual report on July 21, 2011, and is currently working on its second annual report.

Council of the Inspectors General on Integrity and Efficiency and IG Community Involvement

The IG serves as a member of CIGIE, which provides a forum for IGs from various government agencies to discuss governmentwide issues and shared concerns. Collectively, the members of CIGIE help improve government programs and operations. The IG also serves as a member of CIGIE's Legislation Committee and Inspection and Evaluation Committee, and he leads the Information Technology Subcommittee of the Legislation Committee. The Legislation Committee is the central point of information regarding legislative initiatives and congressional activities that may affect the community, such as proposed cybersecurity legislation that was reviewed during the reporting period. The Inspection and Evaluation Committee provides leadership for the inspection and evaluation community's efforts to improve agency program effectiveness by maintaining professional standards; leading the development of protocols for reviewing management issues that cut across departments and agencies; promoting the use of advanced program evaluation techniques; and fostering awareness of evaluation and inspection practices in OIGs.

The Associate IG for Legal Services serves as the Vice Chair of the Council of Counsels to the IG, and her staff attorneys are members of the council. In addition, the Associate IG for Audits and Attestations serves as chair of the IT Committee of the Federal Audit Executive Council and works with audit staff throughout the IG community on common IT audit issues.

Financial Regulatory Coordination

To foster cooperation on issues of mutual interest, including issues related to the current financial crisis, the IG meets periodically with the IGs from other federal financial regulatory agencies: the FDIC, Treasury, the NCUA, the SEC, the Farm Credit Administration, the CFTC, the Pension Benefit Guaranty Corporation (PBGC), the Export-Import Bank, and the FHFA. In addition, the Associate IG for Audits and Attestations and the Associate IG for Inspections and Evaluations meet with their financial regulatory agency OIG counterparts to discuss various topics, including bank failure material loss review best practices, annual plans, and ongoing projects. We also coordinate with the Government Accountability Office regarding financial regulatory and other related issues.

Appendixes

Appendix 1a
Audit, Inspection, and Evaluation Reports Issued to the Board with Questioned Costs during the Reporting Period[a]

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

a. Because the Board is primarily a regulatory and policymaking agency, our recommendations typically focus on program effectiveness and efficiency, as well as strengthening internal controls. As such, the monetary benefit associated with their implementation typically is not readily quantifiable.

Appendix 1b
Audit, Inspection, and Evaluation Reports Issued to the CFPB with Questioned Costs during the Reporting Period[a]

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

a. Because the CFPB is primarily a regulatory and policymaking agency, our recommendations typically focus on program effectiveness and efficiency, as well as strengthening internal controls. As such, the monetary benefit associated with their implementation typically is not readily quantifiable.

Appendix 2a
Audit, Inspection, and Evaluation Reports Issued to the Board with Recommendations that Funds Be Put to Better Use during the Reporting Period[a]

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

a. Because the Board is primarily a regulatory and policymaking agency, our recommendations typically focus on program effectiveness and efficiency, as well as strengthening internal controls. As such, the monetary benefit associated with their implementation typically is not readily quantifiable.

Appendix 2b
Audit, Inspection, and Evaluation Reports Issued to the CFPB with Recommendations that Funds Be Put to Better Use during the Reporting Period[a]

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

a. Because the CFPB is primarily a regulatory and policymaking agency, our recommendations typically focus on program effectiveness and efficiency, as well as strengthening internal controls. As such, the monetary benefit associated with their implementation typically is not readily quantifiable.

Appendix 3a
OIG Reports to the Board with Recommendations that Were Open during the Reporting Period[a]

Report Title	Issue Date	Recommendations: No.	Recommendations: Mgmt. Agrees	Recommendations: Mgmt. Disagrees	Status of Recommendations: Last Follow-up Date	Status of Recommendations: Closed	Status of Recommendations: Open
Evaluation of Service Credit Computations	08/05	3	3	–	03/07	1	2
Security Control Review of the Central Document and Text Repository System (Nonpublic Report)	10/06	16	16	–	03/12	16	–
Audit of the Board's Payroll Process	12/06	7	7	–	03/10	3	4
Security Control Review of the Internet Electronic Submission System (Nonpublic Report)	02/07	13	13	–	09/09	12	1
Audit of the Board's Compliance with Overtime Requirements of the Fair Labor Standards Act	03/07	2	2	–	03/08	1	1
Security Control Review of the FISMA Assets Maintained by FRB Boston (Nonpublic Report)	09/08	11	11	–	09/11	10	1
Evaluation of Data Flows for Board Employee Data Received by OEB and its Contractors (Nonpublic Report)	09/08	2	2	–	03/11	1	1
Audit of the Board's Information Security Program	09/08	2	2	–	11/11	2	–
Control Review of the Board's Currency Expenditures and Assessments	09/08	6	6	–	03/10	5	1
Audit of Blackberry and Cell Phone Internal Controls	03/09	3	3	–	09/11	2	1
Security Control Review of the Audit Logging Provided by the Information Technology General Support System (Nonpublic Report)	03/09	4	4	–	09/11	3	1
Audit of the Board's Processing of Applications for the Capital Purchase Program under the Troubled Asset Relief Program	09/09	2	2	–	03/12	2	–
Audit of the Board's Information Security Program	11/09	4	4	–	11/11	4	–
Security Control Review of the Lotus Notes and Lotus Domino Infrastructure (Nonpublic Report)	06/10	10	10	–	–	–	10
Audit of the Board's Information Security Program	11/10	3	3	–	11/11	3	–
Security Control Review of the Internet Electronic Submission System (Nonpublic Report)	12/10	6	6	–	–	–	6
Audit of the Board's Transportation Subsidy Program	03/11	3	3	–	–	–	3
Response to a Congressional Request Regarding the Economic Analysis Associated with Specified Rulemakings	06/11	2	2	–	–	–	2

a. 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 agency 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 or are referring it to the appropriate oversight committee or administrator for a final decision.

Appendix 3a—*continued*
OIG Reports to the Board with Recommendations that Were Open during the Reporting Period

Report Title	Issue Date	Recommendations			Status of Recommendations		
		No.	Mgmt. Agrees	Mgmt. Disagrees	Last Follow-up Date	Closed	Open
Review of the Failure of Pierce Commercial Bank	09/11	2	2	–	–	–	2
Security Control Review of the Visitor Registration System (Nonpublic Report)	09/11	10	10	–	–	–	10
Audit of the Board's Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act	09/11	1	1	–	12/11	1	–
Summary Analysis of Failed Bank Reviews	09/11	3	3	–	–	–	3
Evaluation of Prompt Regulatory Action Implementation	09/11	1[b]	1	–	–	–	1
Audit of the Board's Information Security Program	11/11	1	1	–	–	–	1
Review of RBOPS' Oversight of the Next Generation $100 Note	01/12	2	2	–	–	–	2
Security Control Review of the National Remote Access Services System (Nonpublic Report)	03/12	8	8	–	–	–	8

b. This recommendation was directed jointly to the OCC, the FDIC, and the Board.

Appendix 3b
OIG Reports to the CFPB with Recommendations that Were Open during the Reporting Period

		Recommendations			Status of Recommendations		
Report Title	Issue Date	No.	Mgmt. Agrees	Mgmt. Disagrees	Last Follow-up Date	Closed	Open
None with OIG recommendations							

Appendix 4a
Audit, Inspection, and Evaluation Reports Issued to the Board during the Reporting Period

Title	Type of Report
Reviews of Bank Failures	
Material Loss Review of Park Avenue Bank	Evaluation
Review of the Failure of Legacy Bank	Evaluation
Material Loss Review of First Chicago Bank and Trust	Evaluation
Information Technology Audits	
Audit of the Board's Information Security Program	Audit
Security Control Review of the National Remote Access Services System (Nonpublic Report)	Audit
Program Audits and Evaluations	
Review of RBOPS' Oversight of the Next Generation $100 Note	Evaluation
Audit of the Board of Governors of the Federal System Financial Statements as of and for the Years Ended December 31, 2011 and 2010	Audit
Audit of the Federal Financial Institutions Examination Council Financial Statements as of and for the Years Ended December 31, 2011 and 2010	Audit
Status of the Transfer of Office of Thrift Supervision Functions	Evaluation
Inquiry into Allegations of Undue Political Interference with Federal Reserve Officials Related to the 1972 Watergate Burglary and Iraq Weapons Purchases during the 1980s	Evaluation

Total Number of Audit Reports: 4
Total Number of Inspection and Evaluation Reports: 6

Full copies of the public reports are available on our website at **http://www.federalreserve.gov/oig/default.htm**

Appendix 4b
Audit, Inspection, and Evaluation Reports Issued to the CFPB during the Reporting Period

Title	Type of Report
Information Technology Audits	
Audit of the Bureau of Consumer Financial Protection's Information Security Program	Audit

Total Number of Audit Reports: 1
Total Number of Inspection and Evaluation Reports: 0

Full copies of the public reports are available on our website at http://www.federalreserve.gov/oig/default.htm

Appendix 5
OIG Peer Reviews

Government auditing and investigative standards require that our audit and investigative units each be reviewed by a peer OIG organization every three years. Section 989C of the Dodd-Frank Act amended the IG Act to require that OIGs provide in their semiannual reports to Congress specified information regarding (1) peer reviews of their respective organizations and (2) peer reviews they have conducted of other OIGs. The following information addresses these Dodd-Frank Act requirements.

- During the reporting period, the PBGC OIG completed its peer review of our audit organization's quality control system in place for the period April 1, 2010, through March 31, 2011. The review focused on whether our system of quality control was suitably designed and whether we were complying with the quality control system, in order to provide us with reasonable assurance of conforming with applicable professional standards. The PBGC OIG review concluded that the system of quality control for our audit organization in effect for the one-year period ended March 31, 2011, was suitably designed and complied with to provide us with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Federal audit organizations can receive a rating of *pass*, *pass with deficiencies*, or *fail*. The PBGC OIG assigned a peer review rating of *pass* for the period reviewed. There were no report recommendations, nor were any peer review recommendations pending from any previous peer reviews of our audit organization. We provided copies of the peer review report to the appropriate entities.

- The last peer review of the OIG's Investigations program was completed in March 2008 by the U.S. Government Printing Office OIG. No recommendations from this or any prior peer reviews are pending. On June 9, 2010, the U.S. Attorney General approved the OIG's request to exercise statutory law enforcement authority. As a result and in accordance with Attorney General guidelines, Investigations' next peer review is due three years from the date of receiving statutory law enforcement authority.

- Our audit staff began preparations for conducting a peer review of the Office of Personnel Management's audit organization. We anticipate issuing our report during the next reporting period.

Copies of our peer review reports are available on our website at http://www.federalreserve.gov/oig/peer_review_reports.htm.

Appendix 6
Cross-References to the IG Act

Indexed below are the reporting requirements prescribed by the IG Act with the contents of this report.

Section	Source	Page(s)
4(a)(2)	Review of legislation and regulations	34
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 prosecutorial authorities	32
5(a)(5);6(b)(2)	Summary of instances where information was refused	None
5(a)(6)	List of audit, inspection, and evaluation reports	46-47
5(a)(7)	Summary of particularly significant reports	None
5(a)(8)	Statistical table of questioned costs	39-40
5(a)(9)	Statistical table of recommendations that funds be put to better use	41-42
5(a)(10)	Summary of audit, inspection, and evaluation reports issued before the commencement of the reporting period for which no management decision has been made	None
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
5(a)(14), (15), and (16)	Peer review summary	48

Table of Acronyms and Abbreviations

BEP	Bureau of Engraving and Printing
Board	Board of Governors of the Federal Reserve System
BS&R	Division of Banking Supervision and Regulation
CFPB	Consumer Financial Protection Bureau
CFTC	Commodity Futures Trading Commission
CIGFO	Council of Inspectors General on Financial Oversight
CIGIE	Council of the Inspectors General on Integrity and Efficiency
CIO	Chief Information Officer
CLD	Construction, Land, and Land Development
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
FBI	Federal Bureau of Investigation
FDI Act	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FHFA	Federal Housing Finance Agency
First Chicago	First Chicago Bank and Trust
FISMA	Federal Information Security Management Act of 2002
FRB Atlanta	Federal Reserve Bank of Atlanta
FRB Chicago	Federal Reserve Bank of Chicago
FSOC	Financial Stability Oversight Council
IG	Inspector General
IG Act	Inspector General Act of 1978, as amended
ISO	Information Security Officer
IT	Information Technology
Legacy	Legacy Bank
MOU	Memorandum of Understanding
NCUA	National Credit Union Administration
NIST	National Institute of Standards and Technology
NPRM	Notice of Proposed Rulemaking

Table of Acronyms and Abbreviations

NRAS	National Remote Access Services
NXG	Next Generation
OCC	Office of the Comptroller of the Currency
OEB	Office of Employee Benefits
OIG	Office of Inspector General
OMB	Office of Management and Budget
OTS	Office of Thrift Supervision
Park Avenue	The Park Avenue Bank
PBGC	Pension Benefit Guaranty Corporation
PCA	Prompt Corrective Action
Pubweb	Public Website
RBOPS	Division of Reserve Bank Operations and Payment Systems
SEC	Securities and Exchange Commission
SIGTARP	Special Inspector General for the Troubled Asset Relief Program
SP 800-53	Special Publication 800-53, *Recommended Security Controls for Federal Information Systems and Organizations*
SR Letter 07-01	Supervision and Regulation Letter 07-01, *Interagency Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices*
TARP	Troubled Asset Relief Program
Treasury	U.S. Department of the Treasury
UCB	United Commercial Bank

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Mail Stop K-300
Washington, D.C. 20551
Attn: Hotline

or e-mail
OIGHotline@frb.gov

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