

Federal Housing Finance Board

November 20, 1990

MEMORANDUM

No. A90-10A

To: Jack Kemp
Chairman

Date: December 1, 1990

Through: J. Stephen Britt
Executive Director

From: Gary B. Townsend
Director, Examination Division

Subject: Issue for Decision -- Transfer of Programmatic Responsibilities to the District Bank Directorate from the Office of Inspector General

ISSUE FOR DECISION

Two agency functions, (1) Contracting Officer's Technical Representative (COTR) for the external audit of the Federal Home Loan Banks (FHLBanks), and (2) regulatory oversight of the FHLBanks' internal audit functions, appear to be programmatic, i.e., relating and essential to the oversight and regulation of the FHLBanks. If these are determined to be programmatic, responsibility for these functions, currently assigned to the Office of Inspector General (OIG), should be transferred to the District Bank Directorate (DBD), subject to audits and investigations of the OIG.

BACKGROUND

The Inspector General Act of 1978, as amended ("IG Act"), and subsequent rulings and interpretations of the Department of Justice regarding the role of Inspectors General (IG) focus IG responsibilities on the conduct "[of] audits and investigations relating to the efficiency and economy of program operations and the prevention and detection of fraud and abuse in such programs." H.R. Rep. No. 584, pp. 12-13. Congress' purpose was to create "independent and objective units" [See 5 U.S.C. App. § 2 (1988)] and to have "an official in the department who would not have responsibility for the operations of the department and would thus be free to investigate and criticize." Memorandum for Jerry G. Thorn, Acting Solicitor, Department of Labor, from Douglas W. Kmiec, Assistant Attorney General, Office of Legal Counsel, Department of Justice, March 9, 1989, p. 10.

Congress intended to avoid situations in which the responsible officials would be charged with auditing and investigating their own offices. Thus, the OIG discharges its statutory oversight duty by conducting investigations and preparing reports that may identify fraud or waste, or by criticizing regulatory policies, investigatory or programmatic methodologies, or the validity of conclusions. Congress did not intend that the IG would become the official responsible for implementing policy or for conducting regulatory or other programmatic activities. Id., p. 11. See also, 5 U.S.C. App. §9(a)(2)(1988), which discusses the transfer of functions to Inspectors General. There, Congress explicitly states that "there shall not be transferred to an Inspector General . . . program operating responsibilities." ^{1 2}

DISCUSSION

Currently, the Federal Housing Finance Board's (FHFB) Office of Inspector General (OIG) is responsible for two functions that appear to be programmatic. These are discussed below:

1. COTR, External Auditor

Since the mid-1970s, the annual financial audit of the FHLBanks has been accomplished under multi-year contract with a public accounting firm. While the actual management

1. "Regulatory investigations", which have as their objective an evaluation of regulatory compliance by private parties, can be distinguished from investigations conducted by an Inspector General, which generally have as their objective the detection and elimination of waste and fraud among an agency's employees, contractors, grantees, and other recipients of federal funds. Notwithstanding, Inspectors General clearly have authority to conduct investigations of private parties who do not receive federal funds when they act in collusion with the employees of a federal agency or other recipients of federal funds to avoid regulatory compliance. Kmiec Memorandum, Op. Cit., footnote, p. 1.
2. Also pertaining to the ability of an IG to conduct investigations of private parties, the memorandum of William P. Barr, Acting Deputy Attorney General, to William M. Diefenderfer, Deputy Director, Office of Management and Budget (July 17, 1990), states in part that IGs may conduct "spot check investigations" of external parties in "oversight reviews of program compliance or enforcement efforts", but that these do not have "as their objective the investigation of external parties per se . . . spot checks are intended to assist in the assessment of the structure and management of agency programs, so that the IG may report on them fully to the agency head and the Congress." [Page 3].

of the contract resides with the Office of Administration, Contracting Officer Technical Representative (COTR) responsibilities have resided with the OIG.

In this capacity, the OIG coordinates between the FHLBanks' internal auditors and the accounting firm partner-in-charge, who coordinates the activities of the various external audit branch offices that actually conduct the district FHLBank audits. Problems, comments, and suggestions are communicated through the OIG to the account partner for resolution. Also, the OIG reviews the external audit reports for sufficiency, given the terms of the contract, and approves payments to the external auditor.

Together with the Office of Administration, OIG also solicits and reviews bids for external audits, and awards contracts.

2. Oversight of FHLBank Internal Auditors

With respect to the internal audit function of the FHLBanks, the DBD and OIG monitor the activities of the internal auditor function within the FHLBanks, developing and setting systemwide policies and procedures. OIG fields comments from the Internal Auditors and serves as a point of contact for comments and suggestions to the external audit partner-in-charge. DBD monitors internal audit activity. The internal auditors send copies of audit plans and reports as these are produced by the internal auditors.

In 1986-1988, OIG also conducted field audits of the internal audit functions of each of the FHLBanks. These were designed to identify audit weaknesses and to cause corrective action to be taken by the internal audit departments of the FHLBanks.

ANALYSIS

1. COTR, External Auditor

The quality, adequacy, and effectiveness of the external audit is a primary regulatory concern, affecting both the scope and depth of examination and other regulatory efforts. External audit COTR responsibilities bear directly on DBD efforts to (1) understand the scope and methodologies of the external auditors in order to maintain FHLBank safety and soundness and (2) keep abreast of audit-related problems, preliminary conclusions, and/or control weaknesses in the FHLBanks.

If COTR responsibilities are transferred, the OIG is not precluded from conducting investigations and audits designed to provide the Board with valuable and timely information on DBD effectiveness in its regulation of the FHLBanks or its conduct of its COTR responsibilities.

2. Oversight of FHLBank Internal Auditors

Oversight of FHLBank internal auditors requires that the Examination Division, in each examination, must assess the quality and effectiveness of internal audit and the reliance that may be placed on its conclusions. The report of examination will include relevant comments regarding any weaknesses noted in the internal audit function.

As with COTR responsibilities, if internal audit oversight is transferred to DBD, the OIG is not precluded from conducting investigations and audits on DBD effectiveness in performing its oversight of the internal audit departments of the FHLBanks.

CONCLUSIONS

Regarding both functions, the interest of the OIG appears once removed from the primary interest that DBD has, as the regulatory entity. Because DBD's interest is more direct and because the OIG's focus is on FHFB effectiveness, rather than whether the external auditor or FHLBanks meet their respective missions, DBD has a clear programmatic interest that the OIG does not have.

In its strategic plan for the FHFB, McKinsey and Company recommended that OIG responsibilities should be consistent with other agencies, i.e., that it should be independently responsible to monitor the performance of agency programmatic functions. The OIG of the Board of Governors of the Federal Reserve has indicated that functions similar to those discussed above have been assigned in the Federal Reserve System to regulatory offices, subject to audit by the OIG.

After extensive internal discussions and review of operations in other banking regulatory agencies, we agree that these functions are programmatic and should be reassigned to DBD. We see this approach as consistent with the IG Act, proper division of responsibilities, and with approaches taken by other regulatory agencies.

RECOMMENDATIONS

(1) That the COTR responsibility for the external audit is assigned to the District Bank Directorate, Examination Division.

APPROVE: *[Signature]* DISAPPROVE: _____

COMMENT: _____

DATE: 12/1/90

(2) That the oversight responsibility for the internal auditors in each of the twelve Federal Home Loan Banks is assigned to the District Bank Directorate, Examination Division.

APPROVE: *[Signature]* DISAPPROVE: _____

COMMENT: _____

DATE: 12/1/90

Attachments (2)