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

GENERAL GOVERNMENT
DIVISION

JULY 16, 1980

B-197162



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The Honorable Jay Janis
Chairman, Federal Home Loan
Bank Board

Dear Mr. Janis:

Subject: [Opportunities to Further Improve Internal
Auditing in the Federal Home Loan Bank
Board] (GGD-80-90)

This report describes our review of the Federal Home Loan Bank Board's internal audit function. We assessed the activities of the Internal Review Office, which is responsible for internal auditing, against widely accepted professional internal auditing standards formulated for private industry and government.

Since its reorganization in January 1978, the Bank Board's internal audit organization has made several improvements, but it needs to do more. Some of the Office's improvements include:

- insuring that the Director reports directly to the Chairman,
- upgrading the staff, and
- removing all audit scope limitations and broadening the scope of reviews.

However, opportunities for further improvements exist in the areas of data processing audits, guidance to Federal Home Loan Bank internal audit units, and reporting changes in program plans to the Bank Board.

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1978 RESTRUCTURING CREATED AN
INDEPENDENT INTERNAL AUDIT UNIT,
THE INTERNAL REVIEW OFFICE

Internal auditing at the Bank Board has undergone many organizational changes since its inception in the late 1930s. In 1948, an Office of the Auditor was created and charged with auditing the administrative accounts of the Bank Board, the Federal Savings and Loan Insurance Corporation, and the Home Owner's Loan Corporation. In addition, the internal auditor was responsible for performing annual financial audits of the Federal Home Loan Banks.

In an October 1977 report, 1/ we recommended that the Bank Board reorganize its internal audit unit because the organizational placement, within the Office of Management and Administration, did not enhance internal audit independence. All activities within the Office of Management and Administration were subject to internal audit and therefore, auditors assigned to these reviews were placed in the position of having to review and report on the activities and deficiencies of management within their own organization.

In January 1978, the Bank Board, following our recommendation, dissolved the old internal audit structure and created a new Office of Internal Review within the Office of the Chairman. Organizationally independent, all of this unit's audit reports were sent directly to the three-member Bank Board. The unit was renamed the Internal Review Office in February 1978.

The Internal Review Office's current responsibilities include providing guidance for the effective performance of internal auditing at the Federal Home Loan Banks; coordinating the annual financial audits of each Bank performed by certified public accounting firms; performing financial control, economy and efficiency, and program results audits of Bank Board activities; and acting as a liaison with us.

1/ "Examination of Financial Statements of the Federal Home Loan Banking System: A Favorable Opinion But Some Management Problems." (FOD-77-15, October 25, 1977)

The Internal Review Office total fiscal year 1980 budget is \$735,000, including \$585,000 for 14 authorized positions, and \$150,000 for certified public accounting firm financial audits of the individual Banks.

INTERNAL REVIEW OFFICE NEEDS
TO INCREASE ITS COMMITMENT TO
DATA PROCESSING AUDITING

Although the Internal Review Office initially recognized data processing auditing as an important area at the Bank Board, it has subsequently reduced its effort. While 9 percent of the audit effort was initially planned for this area in 1979, no data processing audits have been completed since early 1978. Further, the Internal Review Office's participation in reviewing proposed data processing system changes has also been significantly reduced, even though many important Bank Board activities make extensive use of data processing capabilities.

In our recent report 1/ summarizing findings on Federal internal audit organizations, we commented on internal audit coverage of data processing activities. We concluded that, because of the magnitude of automated systems and their impact on agency operations, programs, and resources, internal auditing was needed to assess the adequacy, effectiveness, and reliability of these systems.

In recognition of the expanded role of the auditor with the evolution of the computer, we recently expanded our policies and procedures for auditing Government programs and functions to provide that:

- The auditor shall actively participate in reviewing the design and development of new data processing systems or applications, and significant modification thereof, as a normal part of the audit function.

- The auditor shall review general controls in data processing systems to determine that (a) controls

1/"GAO Findings on Federal Internal Audit--A Summary"
(FGMSD 80-39, May 27, 1980)

have been designed according to management direction and legal requirements and (b) such controls are operating effectively to provide reliability of, and security over, the data being processed.

--The auditor shall review application controls of installed data processing systems to assess their reliability in processing data in a timely, accurate, and complete manner.

Initially, the Internal Review Office planned to perform reviews of data processing audit activities. When the Internal Review Office was established, one of the existing audit managers was given responsibility for conducting data processing audits. In its 1979 audit program plan (covering the period of October 1, 1978, through December 31, 1979), the Internal Review Office listed four specific reviews of data processing activities for initiation in 1979, including audits of computer security and internal controls. In addition, the Internal Review Office actively participated in reviewing various Bank Board data processing system proposals.

During 1979, however, plans to review data processing activities were changed. The data processing auditor was assigned other responsibilities, which allowed him to devote only approximately 20 percent of his time to data processing auditing duties. When this audit manager left in May 1979, he was not replaced. Only one of the four data processing reviews scheduled for 1979 was initiated but this review was not completed. In addition, the Internal Review Office's role in reviewing proposed data processing applications has been lessened to the point where it did not make any formal comments regarding data processing proposals to agency management in 1979.

Data processing activities are not included in the 1980 audit plan and data processing audit responsibilities will not be consolidated under a specific audit manager. The director believes that a full-time data processing auditor is not justified in light of other audit activities planned. The Internal Review Office is arranging for a data processing firm to develop a program for use by the Internal Review Office to audit the rate of return calculation by the Federal Savings and Loan Insurance Corporation. The Internal

Review Office has not conducted an operational survey of data processing activities to determine if audits are warranted as it has done for other Bank Board operations. We believe data processing activities are an important part of Bank Board operations and should be included in the Internal Review Office audit plans.

INTERNAL REVIEW OFFICE NEEDS TO
CONTINUE IMPROVING ITS GUIDANCE
TO FEDERAL HOME LOAN BANKS' INTERNAL
AUDIT UNITS

Although the Internal Review Office has taken several actions to provide better guidance to internal auditors in the 12 Federal Home Loan Banks, some Bank internal audit units still lack effective audit program planning and report recommendation follow up procedures.

The Internal Review Office has the responsibility to supervise the internal audit activities of the 12 Federal Home Loan Banks. This responsibility has historically included providing the Bank internal auditors with audit standards and policies, performing onsite review of individual Bank internal audit activities, and coordinating the annual financial examinations performed by certified public accounting firms at each Bank.

Currently, all 12 Federal Home Loan Banks have internal audit units, ranging in size from one to five professionals. These units concentrate primarily on financial auditing. Their combined fiscal year 1979 budgets totaled approximately \$1.5 million.

The Bank Board has long recognized the need to provide guidance to Bank internal audit units. In July 1975, the Office of Federal Home Loan Banks (now the Office of District Banks), issued written guidance for Bank internal auditors, including the publication, Internal Auditing Standards for Federal Home Loan Banks. The Chief Accountant developed the Bank internal auditing standards and also conducted periodic reviews of Bank internal audit departments to assess their compliance with the standards. In addition, the Chief Accountant coordinated the contracts with certified public accounting firms to conduct annual audits at the

District Banks. When the internal audit unit was reorganized in 1978, the Chief Accountant, and most of his responsibilities, were transferred to the Internal Review Office.

In line with its supervisory responsibilities, the Internal Review Office supplemented the internal auditing guidance for the Banks, coordinated certified public accountant audits, and began evaluating Bank internal auditing units. The Internal Review Office developed two supplemental manuals for Bank internal auditors: Illustrative Internal Audit Program For Federal Home Loan Banks and Internal Audit Methodology for Federal Home Loan Banks. In addition, the Internal Review Office established a contractual requirement that certified public accounting firms will evaluate Bank internal audit units. The Internal Review Office also began evaluating Bank internal audit units using a questionnaire approach.

Although the Internal Review Office has taken several positive steps in carrying out its supervisory responsibilities, it can improve its guidance to Bank internal audit units. An Internal Review Office review of Bank internal audit practices initiated in early 1979, identified several areas which the current Bank internal auditing guidance did not effectively address. The study showed 11 internal audit units without audit charters, 5 units operating without approved unit plans, and 3 units without effective report recommendation followup procedures.

In addition, a 1979 Conference of Federal Home Loan Bank System Internal Auditor's study compared the Federal Home Loan Bank's internal auditing standards with the Institute of Internal Auditors' standards and found several areas unaddressed in the Bank Board's guidance. These areas included those found by the Internal Review Office--audit charters, program planning, and report recommendation followup.

The Conference has taken initial actions to supplement Bank Board guidance. In the spring of 1979, the Conference adopted the Institute of Internal Auditors' standards as a supplement to its system standards. However, the Conference action does not carry the weight of Bank Board policy because the Conference does not have policymaking authority.

The Internal Review Office initially planned to report to the Board by the end of May 1979 but decided to substantially revise the recommendations to provide a conceptual framework rather than procedural directions. During their Fall 1979 Conference, Bank internal auditors, in a joint effort with the Internal Review Office, developed and adopted resolutions calling for standardization of audit charters, planning policies and reporting approaches. After considering comments from the District Banks, the Internal Review Office and the Office of District Banks will present resolutions to the Bank Board for formal adoption.

INTERNAL REVIEW OFFICE NEEDS
TO REPORT CHANGES IN PROGRAM
PLANS TO THE BANK BOARD

The Internal Review Office completed nine reviews started in 1979, which led to improvements in several Bank Board activities such as contracting and payroll, the Office of Industry Development application evaluation process, and the use of advisory committees. However, a number of changes were made to the audit plans for 1979, the first full year of operations for the Internal Review Office for 1979. Ten of the 25 audits originally planned were not initiated, including reviews of procurement, inventory, budgeting, and selected data processing activities, which were listed in the Bank Board's fraud, waste, and abuse plan. Also, eight reviews experienced delays ranging from 4 to 10 months. The status of internal audit work is presented orally to the Board each quarter and documented as part of the minutes of the Board meeting.

Internal Review Office officials stated that changes in resources and auditing emphasis significantly affected the direction of their 1979 efforts. During part of 1979, the staff level was below the authorized positions while recruiting of new staff took place. Office officials indicated that because of the unit's need to know more about Bank Board operations, they decided to conduct a series of operational surveys to determine if areas warranted full audits. Five such surveys were completed from January 1979 through February 1980 and each resulted in internal survey memorandums. One review resulting from the surveys was initiated in 1979 and three are planned in 1980.

We believe revisions to the annual program plan and the reasons for those changes should be submitted in writing

to the Bank Board together with the status of Internal Review Office work in process.

CONCLUSIONS AND RECOMMENDATIONS

The Bank Board's internal audit organization has made progress since being reorganized in January 1978; however, further improvements are needed in the areas of data processing audits and guidance to Bank internal audit units. We believe data processing activities should be included in the Internal Review Office audit plans. Whether a full-time data processing auditor is needed or existing staff capability is used would depend on the scope and complexity of the reviews planned. We also believe that the additional guidance to Bank internal audit units in the areas of audit charters, program planning, and report recommendation follow-up should be formally adopted and provided to the Bank's internal audit units as soon as possible. We further believe that in addition to the annual program plan, the Bank Board should receive quarterly written status reports on Internal Review activities measuring performance against the plan.

We recommend that you, as Chairman of the Federal Home Loan Bank Board, instruct the Director of the Internal Review Office to:


- Reconsider his view that data processing activities should not be included in the audit plan and request a full-time data processing auditor position, if appropriate.
- Complete and present to the Bank Board the Bank audit charters being considered to correct the problems identified in the surveys of Federal Home Loan Bank internal audit practices.
- Provide the Bank Board with a written status report, as a part of the Internal Review Office's quarterly reporting, listing the initial estimated completion dates of each planned review, the current status of each review, and any changes to the annual audit plan which may have occurred.

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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report are being sent to the Chairmen, Senate Committee on Banking, Housing and Urban Affairs; the Senate Committee on Appropriations; the Senate Committee on Governmental Affairs; the Subcommittee on Financial Institutions, Supervision, Regulation, and Insurance, House Committee on Banking, Finance, and Urban Affairs; the House Committee on Appropriations; and the Subcommittee on Consumer, Commerce, and Monetary Affairs, House Committee on Government Operations.

Sincerely yours,


For William J. Anderson
Director