ANALYSIS OF DIVISION OF SUPERVISION'S 1999 EXAMINATION WORKLOAD

Audit Report No. 99-037
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OFFICE OF AUDITS

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FDIC
Federal Deposit Insurance Corporation
Washington, D.C. 20434

Office of Audits
Office of Inspector General

DATE: August 25, 1999

TO: James L. Sexton, Director
Division of Supervision

FROM: Steven A. Switzer
Deputy Inspector General for Audits

SUBJECT *Analysis of Division of Supervision's 1999 Examination Workload*
(Audit Report No. 99-037)

The Federal Deposit Insurance Corporation (FDIC) Office of Inspector General (OIG) has completed a review of the Division of Supervision's (DOS) 1999 strategic plan to determine how DOS planned to achieve its examination workload requirements with its given resource levels. The increased emphasis on the Year 2000 (Y2K) effort, combined with a downsizing workforce, led the OIG to examine DOS's ability to complete all of the statutory safety and soundness examinations for the 1999 calendar year.

As of December 31, 1998, there were 297 statutory safety and soundness examination delinquencies (207 FDIC examinations, 67 state examinations, and 23 examinations delayed due to pending mergers, acquisitions, or sales) that were carried over into the 1999 workload. The FDIC Chairman has mandated that DOS will conduct all statutory examinations scheduled for 1999, including the 1998 delinquencies, as well as all Y2K initiatives. The goal of this audit was to determine whether DOS, given its 1999 budgeted resource levels, can accomplish its 1999 statutory safety and soundness examination schedules along with the examination and oversight activities connected with the Y2K effort.

As of the date of this report, it appears that DOS is on track for meeting its 1999 examination workload requirements. The OIG will continue to monitor DOS's progress in meeting its workload objectives for the remainder of 1999 and provide interim status reports as needed. In addition to evaluating the DOS workload and staffing resources, we observed additional issues that we believe should be brought to FDIC and DOS management's attention.

BACKGROUND

The FDIC Strategic Plan provides a framework for implementing the agency's mission by setting a course for the organization and guiding decisions about the effective use of resources. The FDIC Strategic Plan is implemented through the Corporate Annual Performance Plan, which is augmented by individual division and office plans from which staffing and budget resources are determined.

According to the FDIC's Strategic Plan, the FDIC's Supervision Program helps to fulfill the FDIC's mission of contributing to stability and public confidence in the nation's financial system by promoting the safety and soundness of insured depository institutions, protecting consumers' rights, and promoting community investment initiatives by FDIC-insured depository institutions. The Supervision Program, Safety and Soundness area, has two strategic goals that support the intended result of having safe and sound insured depository institutions:

- Insured depository institutions appropriately manage risk, including risks posed by Y2K.
- Problem insured depository institutions are recapitalized, merged, closed, or otherwise resolved.

These strategic goals are in turn supported by annual performance goals that represent critical initiatives being carried out during 1999 in support of the Supervision Program, Safety and Soundness area.

We focused on DOS's strategic goal that insured depository institutions appropriately manage risk, including risks posed by Y2K. To promote safe and sound insured depository institutions, the FDIC utilizes a combination of macro-economic, financial, and banking analyses and on-site examination processes that are complemented by off-site reviews and analyses. With regard to the FDIC's examination workload, section 10(d) of the Federal Deposit Insurance (FDI) Act requires annual full-scope examinations of all insured depository institutions. Under the act, as amended by the Reigle Community Development and Regulatory Improvement Act of 1994, and Section 2221 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, federal regulators can extend the examination intervals of certain small institutions to 18 months if various criteria pertaining to a bank's asset size or performance ratings are met.

Section 10(d) of the FDI Act also permits examinations to be alternated with the appropriate state supervisory authority, provided that the federal banking agency determines that the state examination carries out the purpose of a full-scope, on-site examination. The FDIC is the primary federal regulator for approximately 5,900 banks throughout the 50 states and U.S. territories. The FDIC coordinates its examinations with all state regulatory agencies, usually conducting independent alternating examinations with state banking departments. For those states with smaller banking departments, the FDIC typically performs joint examinations, where one examination report is produced and signed by both the FDIC and the state banking department.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this audit was to determine whether DOS, given its current level of resources, can accomplish its 1999 statutory safety and soundness examination schedules along with the examination and oversight activities connected with the Y2K effort. To accomplish this objective, we: (1) interviewed DOS management to discuss the workload planning processes, the core staffing projections, and alternative plans to accomplish the FDIC Chairman's goals; (2) interviewed the Division of Administration's (DOA) Associate Director for Management Review, to discuss DOA's analysis of DOS's approved core staffing levels for 1999; (3) reviewed the Performance Plans and quarterly reports indicating the level of performance actually attained; (4) reviewed and analyzed the core staffing projections submitted by the DOS Regions to DOS Washington; (5) obtained information from DOS regional offices regarding their statutory examination requirements and other examination activities for 1999; and (6) analyzed the information and estimated the number of hours required to accomplish the Chairman's goals and other DOS examination activities for 1999.

Fieldwork was performed exclusively in Washington, D.C. The audit was conducted in accordance with generally accepted government auditing standards. We conducted the audit from February 1999 through June 1999. We have relied on core staffing information provided by DOS. The core staffing data was independently analyzed by the FDIC's DOA and subsequently approved by the FDIC's Board of Directors in conjunction with their approval of the FDIC's 1999 annual budget. In addition, we have relied on some information generated from DOS's Scheduling, Hours, and Reporting Package (SHARP) system; however, we have not tested or verified the reliability of the SHARP system.

RESULTS OF AUDIT

Based on our review of data that DOS provided us, we believe DOS can accomplish its 1999 examination workload requirements. Assuming that there will be no major unscheduled events during 1999, we believe that DOS will be able to fulfill the FDIC Chairman's mandate that all statutory safety and soundness examinations, including 1998 delinquencies, be conducted, as well as the Y2K examinations and associated follow-up reviews.

DOS has taken necessary steps to shift workload priorities, including the reduction of examiner training by 50 percent and significantly reduced work details. However, DOS officials only plan to ensure that the statutory safety and soundness examinations that are part of the FDIC's cycle for 1999, and the FDIC's 1998 delinquencies, will be conducted. They are not ensuring that the state-banking agencies' share of the statutory examination workload will be conducted. In addition, DOS has indicated that some of its examination agreements with various state banking authorities may be compromised in the course of eliminating statutory examination delinquencies and completing the Y2K workload. According to DOS management, the appropriate state banking authorities have been notified of the potential delays. Nevertheless, based upon our analysis, we believe that DOS also has the necessary staff resources to honor all state agreement examinations.

As a result of this review, we have identified issues regarding the managerial oversight of DOS's examination workload as well as DOS's interpretation of the FDIC Chairman's mandate.

Analysis of DOS's 1999 Examination Workload

As part of our analysis, we calculated the available DOS examiner hours and DOS's estimated hours required to complete the various examinations and other associated activities (See table 1 below). The majority of these estimates were obtained from the DOS core staffing projections for 1999. These estimates include estimated hours for conducting Y2K examinations, special activities, back-up exams, visitations, investigations, recruiting, and training for state regulators.

Table 1: 1999 DOS Workload Analysis

RECAP OF DOS HOURS FOR 1999*

Description	Hours
Available Examiner Hours:	
1,573 (Field Examiners) x 1,386 (annual hours per examiner)	2,180,178
PLUS: Team Leader Hours 142 (team leaders) x (1,386/2)**	98,406
** Only 50% of the team leaders available hours are charged to examinations	
Subtotal	**2,278,584**
LESS: Hours to conduct 1998 delinquencies & 99 statutory exams	1,494,288
Year 2000 hours as of 5/31/99 (SHARP Report)	200,539
Year 2000 hours for remainder of 1999 as of 5/31/99	54,425
Special Activities	263,955
Back-up exams	17,328
Visitations	34,877
Investigations	39,391
Recruiting	14,239
Training States	4,572
Subtotal	**2,123,614**
Available Examiner Hours Remaining	**154,970**
Less: Hours needed to conduct 204 "state agreement examinations"	89,531
Total Available Examiner Hours Remaining	**65,439**

Source: Division of Supervision / OIG Analysis

*The projected available examiner hours were calculated using an average of the total available examiner workforce as of 12/31/98 and the projected core staffing number for field examiners as of 12/31/99. This value was multiplied by the projected available hours per examiner, obtained from the core staffing values. The projected hours required to conduct the safety and soundness examinations were based on the average hours for each field office within each region to conduct safety and soundness examinations during 1998. The weighted average for each region was multiplied by the number of statutory examinations slated for 1999 plus the delinquent statutory examinations from 1998.

Our analysis indicates that there are sufficient staff hours for DOS to conduct its portion of the statutory examination requirements (including the 1998 delinquencies), the Y2K examinations, the examinations under state agreements nationwide, and the other activities.

DOS has maintained that the bulk of the 254,964 hours budgeted for Y2K examinations would be expended in the first quarter of 1999, with a significant decrease in Y2K hours for the rest of the year. During the first quarter of 1999, examiners charged 154,135 hours to Y2K activities. As of May 31, 1999 a total of 200,539 hours has been charged to Y2K-related work. Through the first 5 months of 1999, approximately 79 percent of the Y2K workload budget has been expended. If the current downward trend in Y2K activities continues for the remainder of 1999, it appears that DOS is on track to accomplish its examination workload goals.

In conjunction with the FDIC Chairman’s mandate that all 1999 statutory examinations, including the 1998 delinquent examinations and Y2K examinations, be conducted in 1999, we focused on how DOS planned to achieve this goal. According to DOS officials, the Chairman’s mandate was not written, but expressed verbally to DOS management. As a result of this review, we have identified issues regarding the managerial oversight of DOS’s examination workload as well as DOS’s interpretation of the FDIC Chairman’s mandate. The following sections address these issues and, where appropriate, we have offered recommendations.

DOS Plans To Meet the FDIC Chairman’s Mandate

DOS officials explained to us that the FDIC Chairman’s mandate directed DOS to fulfill its Y2K examination workload as well as conduct all 1999 statutorily required safety and soundness examinations and all 1998 delinquent statutory examinations. DOS has interpreted the Chairman’s mandate as applying only to the statutory safety and soundness examinations that are part of the FDIC’s cycle for 1999, and the FDIC’s 1998 delinquencies. They do not interpret the mandate to include that the state banking agencies’ share of the statutory examination workload will be conducted. In addition, other safety and soundness examinations obligated to be conducted by the FDIC, under agreements with state banking agencies, may not be undertaken as DOS is giving these examinations a lower priority. DOS officials informed us that these concessions do not contradict their interpretation of the FDIC Chairman’s mandate.

Specifically, DOS has adopted several strategies during calendar year1999 for meeting the Chairman’s mandate, including:

- Ensuring that the 2,413 statutory examinations scheduled to be conducted by FDIC examiners, and an additional 207 examinations that were delinquent at year-end 1998, are completed or in-progress by year-end 1999;

- Notifying the state regulatory agencies that they are shifting examination priorities away from conducting safety and soundness examinations that the FDIC should conduct under agreements with state agencies but that they are not required to do to meet federal examination requirements; and

- Reducing examiner training from an average of 160 hours to 80 hours per examiner and significantly reducing the number of detail assignments.

In addition, DOS does not plan to ensure the completion of 1,889 statutory examinations scheduled to be conducted by state banking agencies under agreements for alternating examinations with the FDIC, and an additional 67 examinations that were delinquent at year-end 1998. DOS does not consider these examinations as part of the Chairman's mandate.

The FDIC is the primary federal regulator for approximately 5,900 banks. Section 10(d) of the FDI Act allows federal regulators, including the FDIC, to alternate safety and soundness examinations with the appropriate state supervisory authority, provided that the state examination meets the purpose of a full-scope, on-site examination. The FDIC coordinates examinations with state regulatory agencies, usually conducting independent alternating examinations with most state banking departments. Joint examinations are often conducted with small state banking departments.

Federal law places the primary responsibility for completing safety and soundness examinations on the appropriate federal regulatory agency. Therefore, FDIC has responsibility for ensuring that safety and soundness examinations are completed in accordance with statutory frequency requirements. Consequently, regardless of their interpretation of the Chairman's mandate, we believe DOS should closely monitor states examiners' progress in completing statutory safety and soundness examinations.

Recommendation

For DOS to fully comply with statutory examinations during 1999, we recommend that the Director, DOS:

(1) ensure that the statutory examinations scheduled to be conducted by state banking agencies are completed or in-progress by year-end 1999, by monitoring the states' examination status periodically, and providing assistance or conducting examinations as needed to comply with Section 10(d) of the FDI Act.

DOS Washington Needs To Improve the Tracking and Monitoring of Scheduled Statutory Safety and Soundness Examinations

To determine how many statutory examinations needed to be conducted in 1999 to meet the Chairman's mandate, we requested that DOS Washington provide us with:

- the number of statutory examinations due to be conducted by the FDIC during 1999, and
- the number of statutory examinations due to be conducted by the state banking authorities during 1999.

However, this information is not available or monitored at DOS headquarters. Instead, the OIG requested the number of 1999 examinations that DOS would conduct in accordance with section 10(d) of the FDI Act from each of the eight DOS regional offices.

DOS Washington produces a summary quarterly nationwide examination delinquency report based on information compiled by and collected manually from each DOS regional office. The report is produced approximately 1 month after the end of a quarter. The report identifies the number of statutory delinquencies and projected delinquencies for both the FDIC and state banking authorities. While the quarterly delinquency report is an important management tool, it does not provide complete information on the Division's progress in meeting annual performance goals for safety and soundness examinations.

Since the FDIC is obligated to operate under section 10(d) of the FDI Act, maintaining an accurate inventory of required examinations to comply with this statute is of paramount importance. In addition, under the Government Performance and Results Act of 1993, the FDIC, including DOS, is required to prepare a strategic plan that broadly defines the agencies' mission and vision, an annual performance plan that translates the vision and goals of the strategic plan into measurable objectives, and an annual performance report that compares actual results against planned goals. Additional information relating to the number of statutory examinations to be conducted by both the FDIC and states quarterly and annually would provide DOS management a valuable report for measuring and monitoring progress in achieving its workload. Moreover, it would provide DOS a greater degree of assurance of compliance with the statutes.

Recommendation

In order to ensure compliance with statutory examination requirements, we recommend that the Director, DOS:

(2) Require that each regional office provide periodic reports to DOS headquarters indicating the status of meeting the examination schedule. This status report should include the total number of statutory safety and soundness examinations that are due each year, broken out quarterly, for both the FDIC and state examinations and indicating the progress in starting and completing the examinations due each quarter.

Looking forward, consideration should be given to developing a centralized system that can provide DOS management immediate access to the current status of scheduled FDIC and state safety and soundness examinations. At the request of DOS management, the OIG's Information Systems Audit Branch is currently evaluating DOS reporting systems throughout the eight DOS regional offices. We will refer this issue to the OIG team for consideration during this review.

CORPORATION COMMENTS AND OIG EVALUATION

On August 12,1999, the Director, DOS provided a written response to the draft report. The response is presented in appendix I to this report.

The Director, DOS stated that he agreed with the report's recommendations and will implement corrective action in the third quarter of 1999. The Corporation's response to the draft report provided the elements necessary for management's decisions on the report's recommendations. Therefore, no further response to the report is necessary. Appendix II presents management's proposed action on the recommendations.

APPENDIX I

FDIC
Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, DC 20429 Division of Supervision

August 12, 1999

TO: David H. Loewenstein
Assistant Inspector General

FROM: James L. Sexton, Director

SUBJECT: Analysis of Division of Supervision's 1999 Examination Workload

The OIG's analysis of the Division of Supervision's 1999 Examination Workload included two recommendations. The OIG recommended that DOS ensure that the statutory examinations scheduled to be conducted by state banking agencies are completed or in progress by year-end 1999 by monitoring the states' examination status periodically, and providing assistance or conducting examinations as needed to comply with Section 10 (d) of the FDI Act. The Exam Delinquency Report currently being used by the Division monitors examinations that are to be conducted by state banking agencies but are delinquent. However, DOS employees in the Regions work closely with the state banking agencies to ensure that examination schedules are met, and these efforts will be more fully reflected in the revised Exam Delinquency Report, as of the third quarter of 1999 reporting period. This report will be revised to include the number of statutory required examinations the state banking agencies project to start that quarter, the number of statutory required examinations started and the number of statutory required examinations delinquent. The Regions will continue to submit detailed information on the delinquencies, including information on how the delinquencies will be cured. This will provide the Regions with a uniform system for monitoring the states' examination status on a quarterly basis. The Regions will determine the appropriate course of action to be taken on delinquent statutory examinations that are to be conducted by state banking agencies.

The OIG's second recommendation is that DOS report not only delinquent examinations, but also the number of examinations projected to start each quarter and the number of examinations actually started. This change will be implemented in the third quarter 1999 reporting period. As mentioned previously, DOS monitors statutory examination requirements through the Exam Delinquency Report. This report will be changed to include a comparison of exams projected to start and exams actually started.

The OIG also noted that the Division should give some consideration to developing a centralized examination reporting system. The Division is in the process of developing two systems that might be capable of centralizing data on examination frequency and tracking examination delinquencies. The systems are the Automated Regional Information System and the Field Office Management Information System. The Administration Section will be reviewing both of these systems in the near future to determine if they can provide the information now being collected manually from the regions.

If you have any questions or would like additional information, please contact Ben Brown or Teresa Koechel.

cc: P. Zumbrun
K. Marcotte

APPENDIX II

MANAGEMENT RESPONSES TO RECOMMENDATIONS

The Inspector General Act of 1978, as amended, requires the OIG to report the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider FDIC's responses as management decisions in accordance with the act and related guidance, several conditions are necessary. First, the response must describe for each recommendation

- the specific corrective actions already taken, if applicable;
- corrective actions to be taken together with the expected completion dates for their implementation; and
- documentation that will confirm completion of corrective actions.

If any recommendation identifies specific monetary benefits, FDIC management must state the amount agreed or disagreed with and the reasons for any disagreement. In the case of questioned costs, the amount FDIC plans to disallow must be included in management's response.

If management does not agree that a recommendation should be implemented, it must describe why the recommendation is not considered valid.

Second, the OIG must determine that management's descriptions of (1) the course of action already taken or proposed and (2) the documentation confirming completion of corrective actions are responsive to its recommendations.

This table presents the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on management's written response to our report.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Documentation That Will Confirm Final Action	Monetary Benefits	Management Decision: Yes or No
1	The Corporation agreed with the recommendation. DOS will revise the Examination Delinquency Report to more fully reflect the regions' work with the state banking agencies and the regions' plans for how the delinquencies will be cured.	Third Quarter 1999	Third Quarter 1999 Examination Delinquency Report	Not Quantifiable	Yes
2	The Corporation agreed with the recommendation. DOS will revise the Examination Delinquency Report to strengthen its monitoring of statutory examinations.	Third Quarter 1999	Third Quarter 1999 Examination Delinquency Report	Not Quantifiable	Yes