

**FOLLOW-UP AUDIT OF THE IMPLEMENTATION OF THE
RISK-FOCUSED EXAMINATION PROCESS**

Audit Report No. 00-016
May 5, 2000



OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

DATE: May 5, 2000

MEMORANDUM TO: James L. Sexton, Director
Division of Supervision



FROM: David H. Loewenstein
Assistant Inspector General

SUBJECT: Draft Report Entitled
Follow-up Audit of the Implementation of the Risk-Focused Examination Process (Audit Report No. 00-016)

The FDIC Office of Inspector General (OIG) has completed a follow-up audit addressing the FDIC's implementation of the risk-focused process for safety and soundness examinations.

On November 5, 1998, the OIG issued a report entitled *Audit of Implementation of the Risk-Focused Examination Process* that assessed the Division of Supervision's (DOS) initial implementation of this new examination process. The results of that audit showed that while DOS recognized the need to develop and initiate a nationwide risk-focused examination approach, the process was not being implemented in field offices as intended by DOS headquarters management. In response to our audit, DOS took prompt action to incorporate our recommendations in regional director memoranda and ongoing training initiatives. DOS also established a committee to obtain feedback from examiners and to update the examination modules.

This report assesses the overall progress DOS has made in implementing the risk-focused examination approach since our last review. DOS also requested that we include in our review the use of the risk-focused examination approach in situations where the FDIC conducts examinations jointly with a state banking department.

BACKGROUND

On October 1, 1997, the FDIC, in conjunction with the Federal Reserve Board and the Conference of State Bank Supervisors (CSBS), began implementing a new risk-focused examination process designed to focus bank examinations on bank functions that pose the greatest risk exposure. Under the risk-focused approach, examiners target examination resources

on the areas of greatest risk within the bank, thereby increasing the effectiveness of the examination process without requiring increased resources.

The risk-focused examination process attempts to assess an institution's risk by evaluating its ability to identify, measure, evaluate, and control risk. If management controls are properly designed and effectively applied, they should help ensure that satisfactory future performance is achieved. In a rapidly changing environment, a bank's condition at any given point in time may not be indicative of its future performance. The risk-focused examination process seeks to strike an appropriate balance between evaluating the condition of an institution at a certain point in time and evaluating the soundness of the bank's processes for managing risk. Moreover, the risk-focused approach may involve less regulatory burden by testing, rather than duplicating, the work of audit and management review functions.

To ensure consistent application nationwide, DOS developed examination procedure modules to provide examiners with a tool to focus on risk management and to establish an appropriate examination scope. There are nine core examination modules that examiners must address at every examination and eight supplemental modules that address specialized areas such as international banking and credit card lending. Each module contains a series of examination procedures for examiners to consider when evaluating an institution's risk. Instructions in the examination modules provide that "the most effective and efficient examination approach focuses examiner resources on validating bank management's ability to identify, measure, monitor, and control risks." Internal audits, external audits, loan reviews, and other control activities are integral to a bank's own assessment of its risk profile. Use of the risk-focused examination modules is mandatory at every DOS safety and soundness examination.

During 1998, the OIG reviewed the FDIC's initial implementation of the risk-focused examination process. At that time, we found that most examiners were unclear as to the goals and objectives of the risk-focused examination approach, examination modules were not being completed as intended, and examiners were not using the automated software because they felt it was too cumbersome and was adding to the time and effort necessary to complete bank examinations. In addition, DOS management had not developed a comprehensive evaluation system to monitor the progress in implementing the risk-focused approach. The report contained five recommendations to DOS management to help improve the implementation of the risk-focused examination process. Those recommendations were as follows:

- (1) Develop and communicate to examiners the program's goals and objectives that convey management's specific expectations for the processes and outcomes of the risk-focused examination process, including the amount of effort expected for the planning phase of examinations and the use of the modules during the examination;
- (2) Clarify DOS's policy and instructions to examiners as to what constitutes the adequate documentation of modules;
- (3) Develop a supervisory review process to ensure that examination modules are used consistently and contain adequate supporting documentation;

- (4) Provide a refresher course to all field examiners on the use of the Examination Documentation (ED) software and provide clarification on issues that have emerged since the modules have been instituted; and
- (5) Develop a comprehensive evaluation system that systematically monitors and assesses DOS's progress in achieving desired risk-focused goals and objectives and uses evaluation results to improve program processes and products.

The Director of DOS agreed with the report's recommendations. In response, DOS issued a series of divisional memoranda clarifying the program's goals and objectives along with providing additional training to examiners to assist them in implementing the risk-focused process.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our audit objectives were to: (1) assess the progress made by DOS in implementing the risk-focused examination process since our last review and (2) determine whether recommendations made in our prior audit report have been implemented.

To accomplish these objectives, we: (1) reviewed a total of 49 examination reports and corresponding workpaper files for examinations conducted using the risk-focused approach in two DOS regions; (2) interviewed management officials in Washington, D.C. and at the Memphis and New York regional offices; (3) interviewed 5 field office supervisors, 10 supervisory examiners, and 18 examiners and assistant examiners; and (4) reviewed the risk-focused examination modules, instructions, and other guidance to examiners pertaining to risk-focused examinations.

We performed fieldwork in Washington, D.C., the DOS Memphis and New York regional offices, and five field offices located in the Memphis and New York regions. We focused our review on examinations that had been performed during the period of April 1, 1999 through October 31, 1999. The audit was conducted in accordance with generally accepted government auditing standards. The audit fieldwork was conducted from October 1999 through February 2000.

RESULTS OF AUDIT

DOS has made progress in implementing the risk-focused examination process. Divisional memoranda and additional training have helped to clarify what is expected of examiners. Examiners we interviewed appear to have a better understanding of the risk-focused process and we noted that the use and documentation of the ED modules have improved since our last audit.

However, we believe there are still some aspects of the process that could be improved. Specifically, we found that there are inconsistencies in the way examiners have been implementing the risk-focused process. Also, many examiners are still uncertain as to what

constitutes adequate documentation of the modules, the supervisory review process varies greatly between field offices, and examiners by and large are not using the automated software except to print out the module questions. We found that the risk-focused examination process appeared to be better implemented at those field offices that had a structured supervisory review process.

One other issue dealing with joint examinations came to our attention that should be addressed by management. Several examiners indicated to us that during a joint examination, they are not sure what to do if state examiners choose not to use the ED modules/risk-focused process. Some examiners told us that they go ahead and complete the modules as best they can while others said that they simply omit the ED modules. DOS should issue guidance to examiners to help clarify their responsibilities during a joint examination.

DOS management was responsive to the five recommendations contained in our last audit report. Although policies and training have helped examiners in implementing the risk-focused process, we believe opportunities exist to achieve a more uniform and consistent risk-focused approach. Accordingly, we have included six additional recommendations in this report that we believe will help DOS to ensure consistency and uniformity nationwide.

EXAMINERS HAVE A BETTER UNDERSTANDING OF THE RISK-FOCUSED EXAMINATION APPROACH

Our prior audit report noted that many examiners were unclear as to the goals and objectives of the risk-focused approach. At the time, we recommended that DOS communicate to examiners the program's goals and objectives including the amount of effort expected for the risk-scoping (pre-planning) phase of examinations and the use of modules during the examination. In response, DOS issued a Regional Director Memorandum entitled *Risk-Focused Examination Process - Program's Goals and Objectives* on December 16, 1998, which conveyed to examiners specific expectations for the risk-focused process, including guidance on the risk-scoping/preplanning phase of the examinations and the use of modules and documentation requirements.

Both the Memphis and New York regions have established policies addressing the risk-scoping phase of the examinations and guidelines for preparing the scope memorandum, which details examination strategy. The policies outline the specific requirements for completing the risk-scoping memorandum and establish review procedures and specific timeframes for completing the scope memorandum. Almost all of the 28 examiners we talked to were clear on what was expected of them in the risk-scoping phase of the examination and most felt they were allowed adequate time to prepare the scope memorandum.

Our review of 49 scope memoranda indicated that the pre-planning phase of an examination has improved since our last audit. We found that in every case the scope memoranda were reviewed and approved by a Field Office Supervisor (FOS) or Supervisory Examiner and regional office officials. Many of the examiners we interviewed stated that they thought the risk-scoping phase was beneficial and because of it they are better prepared to conduct an examination upon entering a bank. Examiners generally felt comfortable reducing the scope in those areas

considered less risky, and they stated that as long as they provide supporting rationale, field office supervisors are supportive of their risk-scoping decisions.

We did find a few instances where the scope memorandum did not detail why examiners were performing or limiting certain areas of the examination or how they intended to limit their review of selected areas. Also, in some cases, it appeared that the Examiner-In-Charge (EIC) did not adequately address the supplemental modules when it seemed necessary. We conveyed these observations to field office and regional office officials, where appropriate. Since these discrepancies appeared to be isolated instances, we are not making any further recommendations related to risk-scoping.

While reviewing the risk-scoping process, we noted that the New York regional office has developed a pre-planning report format that provides comprehensive guidance to examiners that should help to achieve consistency in preparing scope memoranda. DOS management may want to consider using the pre-planning guidance issued by the New York region as a sort of "best practices" example for other regions to follow.

INCONSISTENT USE AND DOCUMENTATION OF EXAMINATION MODULES

The *DOS Manual of Examination Policies* requires that examination procedures and conclusions be sufficiently documented in the workpapers. The manual allows this requirement to be satisfied through the use of the risk-focused examination modules. In response to our prior review, DOS issued a Regional Director Memorandum entitled, *Risk-Focused Examination Program - Documentation Requirements*, dated March 23, 1999, that stipulates and further clarifies examination documentation requirements. The memorandum provides, in part, that the use of the risk-focused examination modules is mandatory at every safety and soundness examination. Examiners are also directed to complete the core analysis decision factors for each module used with either a "yes" or "no" and to provide supporting documentation for each answer. Examiners are not required to answer all core analysis decision factors for those modules where the risk-scoping process indicates that the risk is small and well controlled or where the examiner determines that the module is not applicable.

Although examiner use and documentation of the modules has improved since our last audit, some examiners remain unclear as to what constitutes adequate documentation for completing the core analysis decision factors. We reviewed over 400 examination modules from 49 examination workpaper files. Of these modules, approximately 50 percent did not appear to adequately answer the core analysis decision factors, since the responses either contained only "yes" or "no" answers without underlying support or were left blank. These responses did not include any required supporting documentation about how and why examiners arrived at their conclusions.

DOS program officials with whom we spoke concurred with our conclusions regarding workpaper documentation. Based on interviews conducted, approximately 40 percent of the examiners we interviewed stated that they are still completing the modules at the end of the examination. Those who have implemented the documentation process in conjunction with the

examination indicated that they found the modules to be a good reference resource and that use of the modules made it easier in the event personnel changes were required during an examination. Assistant examiners stated that they found the modules to be a good training tool and that they liked the modules' organization and structure. However, they noted that the usefulness of the modules diminished somewhat after they became familiar with the process. The following represents some of the areas requiring clarification:

- The level of response deemed necessary in addressing the core analysis decision factors. Some examiners were uncertain as to when only a "yes" or "no" response was sufficient, the degree of a response needed to support a conclusion, and when and how targeted expanded procedures should be implemented. However, in two of the five field offices we visited, examiners usually provided comprehensive responses and support for their conclusions.
- The utilization and completion of the supplemental modules and loan references. Some examiners were uncertain whether supplemental modules and loan references had to be completed or even addressed in the pre-examination memorandum when applicable activity was present.
- The effective use of the pre-examination and post-examination memoranda in establishing, limiting, and documenting the scope of reviews. Some examiners were uncertain as to how they should describe a limited or expanded scope and of the need to document scope changes in the post-examination memoranda.

Expanded Analysis

The DOS Memorandum entitled, *Risk-Focused Examination Program - Documentation Requirements* dated March 23, 1999 stipulates, in part, that when significant deficiencies are noted, examiners are required to complete the expanded analysis for the areas that present the greatest degree of risk to the institution. If the risk is material or the activity is not adequately managed, then examiners are also expected to perform an impact analysis.

Based on a review of institutions whose overall performance were CAMELS¹ rated "3" or worse, it appears examiners are not using the expanded analysis procedures as intended. To illustrate, we reviewed seven examination files for banks rated "3" or worse. For these examinations, examiners did not implement expanded review procedures for 18 of 23 components (78 percent) that were deemed to be higher risk areas (rated "3", "4", or "5").

Based on discussions with examiners, there appears to be some confusion on when and how the expanded analysis procedures should be performed. One examiner indicated that expanded procedures were not implemented for a component rated "5" because there were no newly

¹ At the end of a safety and soundness examination, each financial institution is assigned a composite rating based on an evaluation and rating of six essential components of an institution's financial condition and operations. These component factors, known as "CAMELS," address capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk. Composite and component ratings are assigned based on a 1 to 5 numerical scale. A "1" indicates the highest rating, strongest performance and risk management practices, and least degree of supervisory concern, while a "5" indicates the lowest rating, weakest performance, inadequate risk management practices and, therefore, the highest degree of supervisory concern.

identified concerns noted from the prior examination. The examiner also stated that expanded procedures were only necessary in situations where a component was being downgraded. In general, the expanded procedures were seen as cumbersome and unnecessary. A few examiners indicated that they did not want to use them, and that they felt addressing any examination concerns or issues directly was more effective and time efficient. Additionally, examiners seemed unaware that a targeted review of expanded procedures could be implemented without performing a complete review of the expanded analysis section.

Recommendations

We recommend that the Director, DOS:

- (1) Reinforce existing guidance to examiners as to what constitutes adequate use and documentation of the modules and their related sections.
- (2) Provide clarification to examiners regarding when and how the expanded analysis procedures should be used.

SUPERVISORY OVERSIGHT SHOULD BE IMPROVED

At the conclusion of our original audit of the risk-focused approach, we recommended that DOS develop a supervisory review process to ensure that examination modules are used consistently and contain adequate supporting documentation. DOS management agreed with our recommendation and stated in its response: "A supervisory review process by team leaders and field office supervisors will be established to ensure that all examiners are using the modules as directed and that adequate documentation is being provided. The need to provide constructive feedback to examiners will be stressed."

As mentioned earlier, on December 16, 1998, DOS issued its Regional Director Memorandum entitled *Risk-Focused Examination Process - Program's Goals and Objectives*. The memorandum provides that "A review by supervisors, including team leaders and field office supervisors is necessary to ensure the accurate and consistent implementation of the risk-focused approach. Supervisor review and oversight, with feedback to the examination team, should occur often enough to assess each examiner's knowledge and use of the modules and adherence to the risk-focused examination process."

Our follow-up audit found that despite the intent of the DOS memorandum to ensure more consistency, supervisory review and oversight varied between field offices. Of the five field offices we visited, three had little or no supervisory review of examination workpapers above the EIC level. The field office supervisors and team leaders of these three offices confirmed that they did not typically review examination workpapers. In the two field offices where a formal workpaper review process was in place, the ED modules and supporting workpapers were more consistently prepared and adequately documented than in those offices without the review. One office that implemented the supervisory review process most effectively formally documented the team leader/FOS reviews and the corresponding feedback provided to the examiners.

DOS cannot ensure the accurate and consistent implementation of the risk-focused examination program without reviewing examination files and providing timely, constructive feedback to the field office personnel. Supervisory oversight with feedback to the examination team would reinforce implementation of the procedures and foster a more consistent application of the program. This could be accomplished by requiring formal documentation of supervisory reviews and corresponding feedback.

Recommendation

We recommend that the Director, DOS:

- (3) Direct all field offices to perform the necessary supervisory reviews to ensure that adequate supporting documentation is provided and that appropriate feedback is given to examiners.

RISK-FOCUSED EXAMINATION SOFTWARE PROGRAM NOT BEING USED AS INTENDED

The ED software program automates the procedures that examiners should follow when performing an examination. The system is designed so that examiners may enter information in response to the core analysis procedures that can then be compiled and used as supporting documentation to answer the core analysis decision factors. The program was designed to allow examiners to interface with the General Examination System (GENESYS) and to process comments into the Report of Examination. Currently a direct interface does not exist between the GENESYS and ED software program.

The ED software program is still not being utilized as intended. While improvement has been noted in the use of the modules as a part of the risk-focused examination process, areas of weakness still exist. In particular, a large percentage of the examiners are using the detailed procedural guidelines as a post-review checklist. Of these examiners, some continue to print out the core analysis decision factors and to respond to the questions by hand, while others draft report comments into Microsoft Word and then cut and paste the appropriate responses into the modules. Examiners indicated to us some of the following concerns:

- The detail procedures/questions were repetitive.
- The effort required to reformat and reprocess compiled comments into the Core Analysis Decision Factors was time consuming and unproductive.
- The responses formulated to address the Core Analysis Decision Factors do not lend themselves to report comments.
- The system is not user-friendly in formulating report comments and in processing comments on an on-going basis.

- Modules from the prior examination are not being referenced or utilized due to the lack of conciseness and readability of workpapers.

Despite these concerns, most examiners have stated that they found the ED modules to be a good reference resource and a good training tool for assistant examiners. In addition, most examiners stated, in part, that they do not need additional training on the use and function of the modules and/or the software program. As a result, the current use of and concerns over the ED software program appear to be largely a result of the modules' format and not necessarily a result of a lack of examiner understanding or training.

Examiners also expressed concerns of suffering from "software overload." For example, examiners feel a significant amount of their time and energy has been spent on trying to understand and implement numerous new software programs. As a result, due to the volume of changes made within the FDIC's various software systems and examination programs, examiners appear hesitant to embrace a new program that does not provide a direct and tangible impact to the examination process. Examiners have also expressed concerns over the implementation of GENESYS and its future integration with the ED software program. In particular, examiners noted that the conceptual basis of GENESYS as a shared system file is not being implemented and comments are still being formulated in Microsoft Word. Also, examiners reported that they have spent a significant amount of time trying to work around various program functions and glitches. The merging of the two programs may further complicate the examination process and could result in a disjointed and convoluted system.

Recommendation

We recommend that the Director, DOS:

- (4) Reevaluate the ED program. Any reevaluation should: (1) determine how the process could be streamlined to improve the acceptance and use of the program while facilitating the examination process, (2) determine software enhancements needed to improve the ED program and its interface with GENESYS, and (3) determine the training needed to fully implement the program.

MONITORING OF THE RISK-FOCUSED EXAMINATION PROCESS

Our last audit noted that DOS Washington management had not developed a systematic approach to obtaining nationwide feedback on DOS's progress in implementing the risk-focused examination process. We recommended that DOS establish an evaluation system that (1) clearly specifies program goals and objectives and advises regional and field office personnel of precisely what is expected of them, (2) employs clearly stated criteria by which to measure program accomplishments, and (3) assists management in controlling the risks that accompany such a major change in the examination process. These risks include the potential for inconsistent implementation among DOS's regional and field offices.

DOS has reemphasized the risk-focused examination process through a series of divisional memoranda and discussions at DOS meetings and training conferences. During 1999, DOS management provided examiners in the New York, Atlanta, San Francisco, and Kansas City regions with several hours of additional training during breakout sessions at regional conferences. Other regions are scheduled to receive this additional training during their upcoming regional conferences this year.

In addition, DOS created a steering committee for risk-focused examinations which has met several times during 1999 in an effort to update and revise modules and to discuss feedback received from examiners. Steering committee representatives from the FDIC, the Federal Reserve Board, and the CSBS have met to discuss the overall program and objectives. Through the steering committee, DOS has made progress in developing an evaluation system that monitors and assesses progress made in implementing the desired risk-focused goals and objectives.

In addition, we noted that regional office and field office reviews generally did not address implementation of the risk-focused process in a detailed manner. As an exception to this, field office reviews performed by the New York Regional Office made specific recommendations concerning implementation of the risk-focused examination process. Although we are not making any further recommendations in this area, we believe that DOS could strengthen its oversight of the risk-focused process by assessing its use during regional and field office reviews.

CLARIFICATION NEEDED FOR RISK-FOCUSED PROCESS DURING JOINT EXAMINATIONS

Pursuant to a request from DOS management, we also reviewed how the risk-focused process was being implemented during joint examinations.² Examiners we interviewed in the New York and Memphis regions indicated to us that, during a joint examination, they are not sure what to do if state examiners do not use the ED modules/risk-focused process. We were told that some examiners go ahead and complete the modules as best they can while others just omit the ED modules. According to the FDIC examiners, some states have not adopted the risk-focused approach and many state examiners are not experienced in using the risk-focused approach and applicable software.

A survey conducted by the CSBS in May 1999 showed that 32 state banking departments are using the risk-focused process while 18 are not using the process. However, a CSBS official informed us that the numbers documented in their survey may be misleading as the survey did not seek to determine the extent to which the states were using the risk-focused process, including the ED software. One CSBS official stated that even though 32 states were reported as using the risk-focused process and ED software, some states were not using it to any great extent.

² In a joint examination, one Report of Examination is produced and signed by both the FDIC and state banking authority.

Our review of examination workpapers and interviews with field office personnel located in the New York and Memphis regions confirmed that state banking departments do not always use the risk-focused process and document examination results using the ED software. We reviewed the workpaper files for 10 joint examinations. In these 10 examinations there were 90 core modules that should have been completed during the course of the examinations. Our review of the files found that approximately 17 percent of the modules were missing from the joint examination workpaper files. According to FDIC field office personnel, the modules were missing because state examiners had not completed the modules.

According to DOS examiners, some states are operating under budget constraints and do not have computer systems equivalent to those of the FDIC. Also, some state examiners are not experienced in using the ED software because they examine other types of institutions (credit unions and check cashing companies) that do not necessarily require the use of risk-focused procedures. As a result, state examiners frequently do not fill out the ED documentation during a joint examination. Some FDIC examiners told us they complete the ED documentation after the examination is completed to satisfy DOS's workpaper requirements while others stated that if the state is the lead, the modules may not be completed.

DOS's documentation requirements for the risk-focused examination program do not provide specific guidance on how the results of the examination should be documented when the examination is conducted in conjunction with the state banking departments. DOS should issue guidance to examiners to help clarify their responsibilities during a joint examination.

Recommendation

We recommend that the Director, DOS:

- (5) Develop specific guidance for FDIC examiners to follow when conducting risk-focused examinations jointly with state banking departments.
- (6) Instruct regional offices to work with state banking departments to help achieve uniform procedures and workpaper documentation for joint examinations.

CORPORATION COMMENTS AND OIG EVALUATION

On April 14, 2000, the Director, DOS provided a written response to the draft report. The response is presented in its entirety in Appendix I to this report.

The Director, DOS, stated that he agrees with the report's recommendations and proposed a number of corrective actions. The Corporation's response to the draft report provides the elements necessary for management decisions on the report's recommendations. Accordingly, no further response to this report is necessary.



April 14, 2000

TO: David H. Loewenstein
Assistant Inspector General

FROM: James L. Sexton
Director

SUBJECT: Draft Report Entitled – Follow-up Audit of the Implementation of the DOS Risk-Focused Examination Process

Thank you for the opportunity to review and respond to the OIG's draft report entitled Follow-up Audit of the Implementation of the DOS Risk-Focused Examination Process, dated March 15, 2000. The draft report indicates that DOS has made progress in implementing the risk-focused examination process, but additional improvements are necessary to ensure consistent and uniform implementation. DOS agrees with the report's contents and appreciates the sound recommendations contained therein.

The OIG has made six recommendations to improve the risk-focused examination process. Our responses to the OIG's recommendations follow.

Response to Audit Findings

Use and Documentation of Examination Modules

1. Reinforce existing guidance to examiners as to what constitutes adequate use and documentation of the modules and their related sections.

DOS Response: This recommendation relates to the finding that some examiners remain unclear as to what constitutes adequate documentation for completing the core analysis decision factors and limiting the scope of reviews. DOS is aware of the need to reinforce existing guidance, and we remain committed to improving the use and documentation of the examination modules.

As noted in the OIG's draft report, DOS issued a regional director memorandum on March 23, 1999, entitled *Risk Focused Examination Program – Documentation Requirements*. The purpose of the memorandum was to provide examiners with additional guidance for using the examination modules, documenting the attendant decision factors, and limiting the scope of reviews where appropriate. The OIG's draft report also notes that DOS has reinforced existing guidance by conducting break-out sessions during various regional training conferences. Since the OIG's audit, DOS has

conducted Risk-Focused Supervision training at the San Francisco Regional Training Conference on October 7, 1999.

To further reinforce existing guidance on Risk-Focused Supervision, DOS plans to provide all examiners with a one-day Risk-Focused Supervision refresher-training course. The refresher-training will, in part, address adequate use and documentation of the modules. Currently, it is anticipated that the refresher-training will be initiated in late second quarter or early third quarter of 2000.

DOS also continues to work with DOA's Training and Consulting Services Branch (TCSB) to revise core examiner school curriculum to include guidance on Risk-Focused Supervision and the Examination Documentation software program. DOS personnel recently met with TCSB staff in March 2000 to discuss this objective and review progress. It is currently anticipated that the revised core school curricula will be implemented by year-end 2000.

2. Provide clarification to examiners regarding when and how the expanded analysis procedures should be used.

DOS Response: This recommendation primarily relates to the finding that examiners did not implement expanded review procedures for 78 percent of sampled CAMELS components rated "3", "4", or "5." Additionally, discussions with examiners also indicated that some confusion exists as to when and how the expanded analysis procedures should be used. DOS agrees that clarification or additional guidance is necessary, and we continue to emphasize the importance of implementing expanded analysis procedures where appropriate.

As previously noted, DOS issued written guidance to examiners on implementing risk-focused procedures in the March 23, 1999, regional director memorandum entitled Risk Focused Examination Program – Documentation Requirements. The regional director memorandum reiterates that examiners are expected to perform additional testing procedures when the review of internal control systems raises doubts about their effectiveness. The memorandum also states that examiners are required to complete the expanded analysis when significant deficiencies or weaknesses are noted in the core analysis review.

DOS will reinforce the existing guidance on implementing expanded analyses during the Risk-Focused Supervision refresher-training course that will be initiated in late second quarter or early third quarter of 2000. The refresher-training course will include case studies that exemplify when and how expanded analyses should be used.

Supervisory Oversight

3. Direct all field offices to perform the necessary supervisory reviews to ensure that adequate supporting documentation is provided and that appropriate feedback is given to examiners.

DOS Response: This recommendation relates to the finding that the supervisory review and oversight of the Risk Focused Supervision examination process varies between field offices, and feedback to the examination team is not provided often enough to ensure adherence to the program. DOS agrees with this finding and commits to improving supervisory oversight.

As the OIG noted in their draft report, DOS previously issued a regional director's memorandum on December 16, 1998, entitled Risk-Focused Examination Process – Program's Goals and Objectives. The memorandum specified that regional supervisors would oversee a process wherein field office supervisors and team leaders would review this area and provide periodic feedback to examiners.

During March 2000, DOS Planning and Program Development staff completed a quality review of reports of examination to assess each region's implementation of the Risk-Focused Supervision examination process. DOS will provide the regions with feedback on the results of the review in the near future. As part of the feedback, DOS will remind regional directors and field office supervisors of the review requirements detailed in the December 16, 1998, regional directors memorandum entitled Risk-Focused Examination Process – Programs Goals and Objectives. The topic of supervisory reviews will also be included on agendas for upcoming regional director and field office supervisors meetings.

Use of the Risk-Focused Examination Software Program

4. Reevaluate the ED program. Any reevaluation should (1) determine how the process could be streamlined to improve the acceptance and use of the program while facilitating the examination process, (2) determine software enhancements needed to improve the ED program and its interface with GENESYS, and (3) determine the training needed to fully implement the program.

DOS Response: This recommendation primarily results from the OIG's finding that the ED software program is not being used as intended. Specifically, the OIG's audit indicated that examiners continue to use the procedures as a post-review checklist or to respond in handwriting as opposed to using the automated function. DOS agrees with the OIG's finding and continues to evaluate the program's effectiveness.

During the first quarter of 2000, the Interagency Steering Committee for Risk-Focused Examinations and Related Software Products completed a study of the examination workflow. The purpose of the study was (1) to describe when and how the automated tools ED, ALERT, and GENESYS are used in the examination process, and (2) to provide detailed recommendations for integrating and streamlining the various examination software products. The study paper, which is currently in draft format, includes several recommendations for improving the process. We are currently reviewing the recommendations and will determine an appropriate course of action in the near future.

DOS has also assessed training needs for software products. The refresher-training course planned for late second or early third quarter 2000 will include a segment on the ED

software program. In addition, it is currently anticipated that the core examiner training schools will be revised to include a segment on ED use and application. As previously noted, the current plans are to implement the revised core school curricula by year-end 2000.

Implementation of Risk-Focused Process During Joint Examinations

5. Develop specific guidance for FDIC examiners to follow when conducting risk-focused examinations jointly with State banking departments.
6. Instruct regional offices to work with State banking departments to help achieve uniform procedures and workpaper documentation for joint examinations.

DOS Response: Both of these recommendations result from OIG's finding that FDIC examiners are uncertain of workpaper requirements during joint examinations. DOS agrees with the OIG's recommendation and commits to take corrective action.

DOS plans to issue written guidance to the field that addresses the issue of workpaper requirements when the State banking departments are the lead of either the examination or a specific functional activity. Our current plans are to issue this guidance in the second or third quarter of 2000. Regional offices will continue to work with the State banking departments to help achieve uniform procedures and workpaper documentation for joint examinations.

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.

The table on the next page 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.

APPENDIX II

	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 provide a one-day refresher course to all examiners.	December 31, 2000	Training memo	Not Quantifiable	Yes
2	The Corporation agreed with the recommendation. DOS will provide a one-day refresher course to all examiners.	December 31, 2000	Training memo	Not Quantifiable	Yes
3	The Corporation agreed with the recommendation. DOS will perform quality reviews of reports and provide feedback to regions. Supervisory review will be discussed at upcoming regional director and field office supervisors meetings.	December 31, 2000	Feedback report to regional offices and Ro and FO meeting agendas	Not Quantifiable	Yes
4	The Corporation agreed with the recommendation. DOS is in the process of performing a study of examination software and will provide recommendations for improvement. Also, additional training will be provided through the core examiner schools.	December 31, 2000	Report from study and course curriculums	Not Quantifiable	Yes
5	The Corporation agreed with the recommendation. DOS will issue written guidance to examiners that will address issues on joint exams.	September 30, 2000	Written guidance issued	Not Quantifiable	Yes
6	The Corporation agreed with the recommendation. DOS will issue written guidance to examiners that will address issues on joint exams.	September 30, 2000	Written guidance issued	Not Quantifiable	Yes