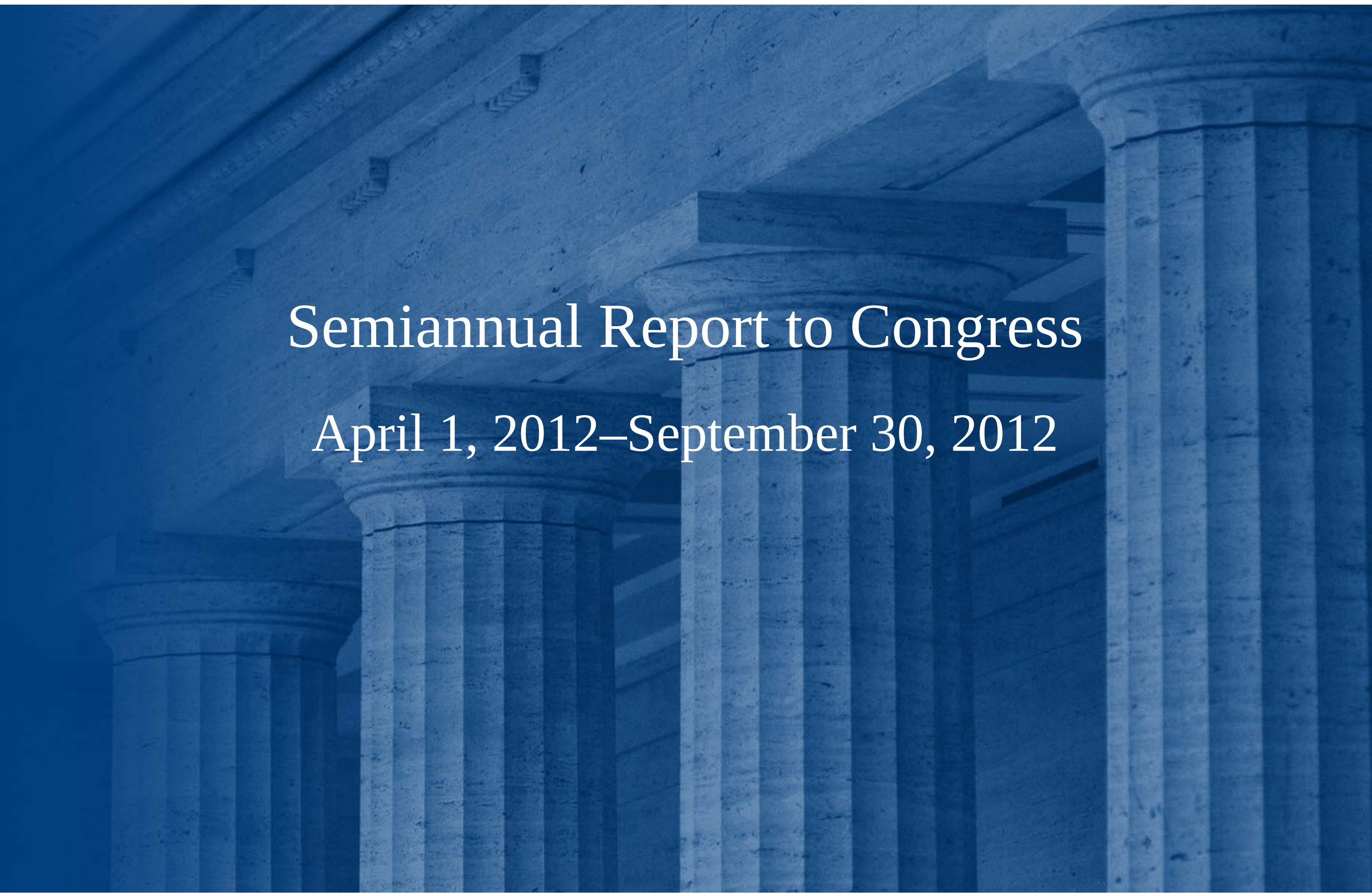
OFFICE OF INSPECTOR GENERAL



Semiannual Report to Congress

April 1, 2012–September 30, 2012

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
CONSUMER FINANCIAL PROTECTION BUREAU

Message from the Inspector General

On behalf of the Board of Governors of the Federal Reserve System (Board) and the Consumer Financial Protection Bureau (CFPB), I am pleased to present our Semiannual Report to Congress, which highlights our accomplishments and ongoing work for the six-month period ending September 30, 2012.

This is a dynamic period for both agencies, as well as for the Office of Inspector General (OIG). We are undertaking a number of strategic and organizational initiatives that have the common goal of maximizing internal and external engagement. Maximized engagement means that we have strong and vibrant relationships within the OIG based on open communication and trust, that we have continuous dialogue with our stakeholders that encourages them to be candid and direct with us, and that we participate actively within the Inspector General community. I strongly believe that increased engagement across all levels will result in an extraordinarily cohesive and motivated OIG team.

My outreach during this reporting period has extended to the chairmen and ranking members of our congressional oversight committees, as well as to other senior congressional members, to inform them of our work and to hear their concerns about the Board and the CFPB. Further, OIG engagement with the Board and the CFPB is allowing us to develop a deeper understanding of the agencies' roles, activities, and programs, which enhances our ability to provide appropriate oversight. Our work during this semiannual reporting period reflects the benefits of our engagement strategy.

My frequent communications with Board Chairman Ben Bernanke, the Board Governors, CFPB Director Richard Cordray, and the CFPB's senior management team also provide us with real-time insight to help us prioritize our work. We recently implemented our online Work Plan, which transformed our previously static Annual Work Plan into a dynamic, living document that is updated on a biweekly basis. This dynamic plan will give our stakeholders a predictable, periodic update of our ongoing and planned work.

During this reporting period, the OIG took part in a project to develop a workforce planning framework that supports our increasing responsibilities and evolving needs. In particular, the workforce planning project has helped us to identify the risks that may influence the current and future work of the OIG, such as the expected increase in work volume and the need for staff with the requisite skills to address expanding oversight areas, so that we can develop action plans now to address these future risks. We are also in the early stages of succession planning, to ensure that we continuously possess staff expertise necessary to provide appropriate oversight of Board and CFPB programs and activities.

I would like to thank the OIG staff for their hard work, dedication, and commitment to our mission, and I would like to thank the Board and the CFPB for their cooperation and support.

Sincerely,

Mark Bialek
Inspector General
October 26, 2012

OFFICE OF INSPECTOR GENERAL

Semiannual Report to Congress

April 1, 2012–September 30, 2012

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

CONSUMER FINANCIAL PROTECTION BUREAU

Contents

Highlights

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

Unauthorized Disclosure of Volcker Rule. During this reporting period, we evaluated whether staff of the Board or the Federal Reserve Bank of New York (FRB New York) had knowledge of or played a role in the unauthorized disclosure of a confidential staff draft of the Volcker Rule notice of proposed rulemaking (NPRM). As part of our review, we also assessed the Board's information-sharing practices for rulemaking activities. An interagency rulemaking team met regularly from January 2011 through October 2011 to jointly develop the Volcker Rule NPRM. As part of this joint rulemaking process, Board employees distributed several versions of the NPRM to the rulemaking team for deliberation, including a version labeled "confidential staff draft" dated September 30, 2011. On October 5, 2011, *American Banker*, a banking and financial services media outlet, published this nonpublic, confidential staff draft of the NPRM on its website. Although our review identified several apparent instances of unauthorized disclosures that occurred during the rulemaking process, we did not find any evidence to indicate that these disclosures originated at the Board or at FRB New York. Nonetheless, we identified opportunities for improving information-sharing controls and procedures for future rulemaking activities.

CFPB's Consumer Response Unit. During this reporting period, we completed a review of the CFPB's Consumer Response unit, which was created to satisfy the Dodd-Frank Act's requirements for processing consumer complaints. We determined that the CFPB has a reasonable process to receive, respond to, and track consumer complaints, and we found that the CFPB's consumer response process generally complies with Dodd-Frank Act requirements, the Privacy Act, and industry best practices. Further, no issues came to our attention to indicate noncompliance with or internal control weaknesses related to the size and nature of the Consumer Response unit's organizational structure, oversight of its contracted contact centers, communication within the Consumer Response unit and throughout the CFPB, coordination with other regulatory agencies for complaint referrals, and the CFPB's schedule for the incremental acceptance of complaints by financial product. However, our review did note areas in which the CFPB can improve processes and strengthen controls in the Consumer Response unit.

Mortgage Foreclosure Processing Risks. During this reporting period, we completed our audit of the Board's actions to analyze mortgage foreclosure processing risks. In fall 2010, issues surfaced regarding documentation deficiencies and irregularities in foreclosure processing. In response, the Board, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) initiated an interagency review of the foreclosure policies and practices of selected federally regulated mortgage servicers. Our audit objective was to assess the Board's activities in response to potential risks related to mortgage foreclosures. Overall, we found that the Board was able to develop approaches and perform activities to assess the foreclosure processing risks. The Board did, however, experience challenges in executing the interagency foreclosure review. Our report contained two recommendations focused on improving the Board's processes for responding to future risks.

Recent Loss at JPMorgan Chase & Co.'s Chief Investment Office. During this reporting period, we initiated a scoping review of the Federal Reserve's supervisory activities related to the recent loss at JPMorgan Chase & Co.'s Chief Investment Office. We completed our scoping review and subsequently initiated evaluation work. Our objectives for this evaluation are to (1) assess the effectiveness of the Board's and FRB New York's consolidated and other supervisory activities regarding JPMorgan Chase & Co.'s Chief Investment Office and (2) identify lessons learned for enhancing future supervisory activities.

Bank President Sentenced. During this reporting period, the president and chief executive officer of Orion Bank, Naples, Florida, was sentenced to 72 months in prison and ordered to pay $36,813,765 in restitution for conspiring to commit bank fraud, misapplying bank funds, making false entries in the bank's books and records, and obstructing a bank examination. The charges relate to his role in a scheme to lend $82 million to "straw" borrowers acting on behalf of an Orion Bank borrower (hereafter referred to as the initial borrower) who had reached the bank's legal lending limit. The loans concealed $15 million in bank funds to be used for the purchase of Orion stock by the initial borrower, in violation of banking laws and regulations. Orion Bank proceeded to fund the loan transactions even though bank executives, including the president, became aware prior to loan closing that the initial borrower's entire loan relationship was based on fraudulent financial documents.

Failed Bank Reviews. We completed two material loss reviews during the reporting period, with associated total estimated assets of $2.3 billion and losses to the Deposit Insurance Fund (DIF) of $493.3 million. For each bank reviewed, we identified the causes of the failure, supervisory issues/concerns, and lessons learned from the failure.

Introduction

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

Consistent with the IG Act, our office, as the OIG for the Board and the CFPB, has the following responsibilities:

- to conduct and supervise independent and objective audits, investigations, and other reviews related to Board and CFPB programs and operations to promote economy, efficiency, and effectiveness within the Board and the CFPB
- to help prevent and detect fraud, waste, abuse, and mismanagement in Board and CFPB programs and operations
- to review existing and proposed legislation and regulations and make recommendations regarding possible improvements to Board and CFPB programs and operations
- to keep the Board of Governors, the Director of the CFPB, and Congress fully and timely informed

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

- Section 38(k) of the Federal Deposit Insurance Act (FDI Act) requires that the OIG review failed financial institutions supervised by the Board that result in a material loss to the DIF and produce a report within six months. The Dodd-Frank Act amended section 38(k) of the FDI Act by raising the materiality threshold, but also by requiring that the OIG report on the results of any nonmaterial losses to the DIF that exhibit unusual circumstances that warrant an in-depth review.
- Section 211(f) of the Dodd-Frank Act requires that the OIG review the Board's supervision of any covered financial company that is placed into receivership and produce a report that evaluates the effectiveness of the Board's supervision, identifies any acts or omissions by the Board that contributed to or could have prevented the company's receivership status, and recommends appropriate administrative or legislative action.
- Section 989E of the Dodd-Frank Act established the Council of Inspectors General on Financial Oversight (CIGFO), which comprises the Inspectors General (IGs) of the Board, the Commodity Futures Trading Commission (CFTC), the U.S. Department of Housing and Urban Development, the U.S. Department of the Treasury (Treasury), the FDIC, the Federal Housing Finance Agency, the National Credit Union Administration (NCUA), the Securities and Exchange Commission (SEC), and the Special Inspector General for the Troubled Asset Relief Program. CIGFO is required to meet at least quarterly to share information and discuss the ongoing work of each IG, with a focus on concerns that may apply to the broader financial sector and ways to improve financial oversight. Additionally, CIGFO is required to issue a report annually that highlights the

IGs’ concerns and recommendations, as well as issues that may apply to the broader financial sector.

- With respect to information technology, the Federal Information Security Management Act of 2002 (FISMA) established a legislative mandate for ensuring the effectiveness of information security controls over resources that support federal operations and assets. Consistent with FISMA requirements, we perform an annual independent evaluation of the Board’s and the CFPB’s information security programs and practices, including the effectiveness of security controls and techniques for selected information systems.

- The USA Patriot Act of 2001 grants the Board certain federal law enforcement authorities. Our office serves as the external oversight function for the Board’s law enforcement program.

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

Audits and Attestations

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

COMPLETED AUDIT WORK AT THE BOARD

Audit of the Board's Government Travel Card Program

During this reporting period, we completed our *Audit of the Board's Government Travel Card Program*, which evaluated the effectiveness of the Board's controls over its Government Travel Card (GTC) program. The Board's GTC program provides employees with the resources to arrange and pay for official business travel and other travel-related expenses and to receive reimbursements for authorized expenses of such travel. The Board participates in the General Services Administration SmartPay2 program and contracts for GTC services with JPMorgan Chase. For the period of our review, April 30, 2010, to April 30, 2011, cardholders made 21,921 transactions totaling approximately $6.4 million.

While we did not identify many instances of improper use, we found that the Board needs to strengthen its internal control framework over the GTC program. We found that some cardholders made unauthorized transactions on their GTCs and that the Board had not blocked or flagged several merchant category codes that could potentially allow cardholders to use their GTCs for unauthorized transactions. We also found that the Board's Travel Office did not close GTC accounts for separating cardholders in a timely manner and approved employees' requests for reimbursement for international lodging based on per-diem instead of actual expenses as required by the Board's *Travel* policy. In addition, we identified a number of GTC cardholders who had delinquent accounts, but the Travel Office did not retain documentation showing that notifications of delinquency were sent to Board employees. Payment delinquencies impact the integrity of the GTC program, so it is important to proactively monitor delinquencies, to include providing early notifications of delinquency.

Our report contained four recommendations designed to help the Board improve internal controls over administering, controlling, and closing GTCs. In comments on a draft of our report, the Director of the Management Division generally concurred with our recommendations and discussed the actions that have been taken, are underway, or are planned to address the report's recommendations.

Audit of the Small Community Bank Examination Process

On February 10, 2012, we received a request from the Chairman of the Senate Committee on Banking, Housing, and Urban Affairs to review the Board's examination process for small community banks, including examination timeliness and how the Board ensures consistency in the administration of examinations throughout the Federal Reserve System. We also reviewed the ability of Board-regulated institutions to question examination results through the Federal Reserve System's Ombudsman program or other appeals processes and the frequency and results of examination appeals.

We found that the Board's examination oversight includes Federal Reserve System–wide supervision and communication, detailed examiner guidance, training, and quality assurance. This structure is designed to ensure consistency of state member bank examinations throughout the Federal Reserve System. We found that, generally, Reserve Banks issued examination reports within the time frame required by the Board's *Commercial Bank Examination Manual*. We also found that all 12 Reserve Banks have established appeals policies that follow Board guidance.

Our report contained one recommendation designed to improve the reliability of the data in the Board's National Examination Data System database. We recommended that the Director of the Board's Division of Banking Supervision and Regulation (BS&R) improve controls for verifying the accuracy of the data entered into the National Examination Data System. The Director of BS&R agreed with the summary conclusions in the report and stated that BS&R had initiated a Federal Reserve System–wide effort to strengthen the examination database management reviews.

Audit of the Board's Progress in Developing Enhanced Prudential Standards

In July 2010, the Dodd-Frank Act established new supervisory responsibilities by designating the Board, acting on its own or pursuant to recommendations by the Financial Stability Oversight Council (FSOC), to establish more stringent prudential standards for large bank holding companies (BHCs), including certain nonbank financial companies that present financial stability risks. We conducted this audit to assess BS&R's approach and activities to comply with Dodd-Frank Act requirements related to developing enhanced prudential standards for large BHCs, including prudential standards that would apply to any nonbank financial company determined by FSOC to be systemically important.

Overall, we found that BS&R had taken a proactive approach to enhancing its supervision of large BHCs, including initiating actions prior to the passage of the Dodd-Frank Act. BS&R has reorganized sections of its division that supervise large BHCs to establish strategic and policy direction for supervisory activities that affect the most significant BHCs and has taken actions to enhance the supervision of large BHCs to meet the related requirements of the Dodd-Frank Act.

As BS&R continues to enhance its approach for supervising large BHCs, we provided two suggestions for management's consideration. We suggested that the Large Institution Supervision Coordinating Committee define and document roles and responsibilities for its subgroups and for coordination with other Board offices, to ensure a clear understanding of each office's purposes and functions. We also suggested that the Director of BS&R finalize the process for distributing and maintaining a complete list of large BHCs that are subject to enhanced prudential standards, including BHCs that may fluctuate above or below the $50 billion threshold in asset size, to effectively and timely supervise BHCs under Dodd-Frank Act requirements. In comments on a draft of our report, BS&R senior management indicated that actions are being taken to fully implement our suggestions.

Audit of the Board's Actions to Analyze Mortgage Foreclosure Processing Risks

During this reporting period, we completed our audit of the Board's actions to analyze mortgage foreclosure processing risks. In fall 2010, issues surfaced regarding documentation deficiencies and irregularities in foreclosure processing. In response, the Board, the OCC, the FDIC, and the OTS initiated an interagency review of the foreclosure policies and practices of selected federally regulated mortgage servicers. Personnel from several Board divisions were engaged in this review, including the Division of Consumer and Community Affairs (DCCA) and BS&R. Our audit objective was to assess the Board's activities in response to potential risks related to mortgage foreclosures.

Overall, we found that the Board was able to develop approaches and perform activities to assess the foreclosure processing risks. The Board did, however, experience challenges in executing the interagency foreclosure review. DCCA and BS&R faced challenges with managing the review's resource demands and timeline, which delayed other scheduled supervisory activities. The examiners who participated on the interagency foreclosure review were challenged to quickly develop an understanding of the complex legal issues related to foreclosures and to examine a third-party service provider's foreclosure processing activities, with which examiners lacked prior experience. DCCA and BS&R were challenged with identifying staff who had the necessary expertise to perform the interagency foreclosure review.

Our report contained two recommendations focused on improving the Board's processes for responding to future risks. We recommended that BS&R and DCCA conduct a lessons-learned exercise to evaluate insights gained from the interagency foreclosure review. We also recommended that BS&R assess whether the current processes and tools used to identify staff with specialized skills and competencies are adequate and define a frequency for the periodic review of skill and competency categories.

In comments on a draft of our report, the Directors of BS&R and DCCA stated that staff have conducted an informal assessment of the interagency foreclosure review initiative, which can be leveraged to satisfy the intent of our first recommendation. Regarding our second recommendation, they stated that they agree that an opportunity exists to assess whether the processes used to identify skills and competencies outside of those needed for basic supervision can be enhanced.

Audit of the Financial Stability Oversight Council's Controls over Non-public Information

The Dodd-Frank Act created FSOC and CIGFO. FSOC is charged with identifying threats to the financial stability of the country, promoting market discipline, and responding to emerging risks to the stability of the nation's financial system. As such, FSOC collects and manages sensitive information that must be properly safeguarded against unauthorized disclosure. CIGFO was established to facilitate information sharing among its IG members and provide a forum for discussion of IG member work as it relates to the broader financial sector. Under certain circumstances, CIGFO may also convene a working group to evaluate the effectiveness and internal operations of FSOC. In 2012, CIGFO convened such a working group to examine FSOC's controls and protocols for ensuring that its non-public information, deliberations, and decisions are properly safeguarded from unauthorized disclosure.[1] To accomplish its objective, the CIGFO working group identified the controls and protocols that have been implemented by each of the FSOC federal agency members to safeguard

1. The entities covered within the scope of this audit were FSOC, the Office of Financial Research, the Federal Insurance Office, and FSOC member agencies with voting rights.

FSOC-related information and the manner in which FSOC as a whole safeguards information from unauthorized disclosure.[2]

To protect the exchange of information, FSOC members entered into a memorandum of understanding governing the treatment of non-public information.[3] The CIGFO working group learned that, at the time of the review, FSOC members had exchanged a limited amount of non-public information. The CIGFO working group identified differences in how FSOC federal agency members mark and handle non-public information. The working group also determined that FSOC has a Data Committee that is coordinating a project to begin to address the differences among its members. In addition, FSOC is developing tools to support secure collaboration. The working group noted that as FSOC develops such tools, it should consider the need for enhanced controls to address new information developed pursuant to the Dodd-Frank Act, such as information related to rulemakings or resolution plans for certain institutions. The audit also noted that FSOC should consider the need for enhanced controls to address information that may need to be exchanged as economic conditions change. Finally, the working group noted that FSOC should consider implementing a contingency plan to quickly and safely exchange information under a crisis environment.

Given the evolving nature of FSOC and the information coordination projects underway, the report did not include recommendations. However, the CIGFO working group encouraged FSOC to continue its ongoing efforts, further examine the issues raised in the report regarding similarities and differences among member agencies, and prepare for possible security upgrades for information that may need to be exchanged as economic conditions change and new threats to the stability of the U.S. financial system emerge.

Security Control Review of the Board's Public Website

Consistent with the requirements of FISMA, we conducted a security control review of the Board's Public Website (Pubweb). Pubweb is listed as a major application on the Board's FISMA application inventory for the Office of Board Members. As part of the Board's Publications Program, Pubweb provides a large and diverse audience, including the public, with information about the mission and work of the Board and the functions of the Federal Reserve System.

Our audit objective was to evaluate the adequacy of selected security controls for protecting the Pubweb application from unauthorized access, modification, destruction, or disclosure. To accomplish this objective, we used a control assessment review program based on the security controls defined in National Institute of Standards and Technology (NIST) Special Publication 800-53, Revision 3, *Recommended Security Controls for Federal Information Systems and Organizations* (SP 800-53). This document provides a baseline for managerial, operational, and technical security controls for organizations to use in protecting their information systems.

Our review of the Pubweb application showed that, in general, controls are adequately designed and implemented. However, we identified opportunities to strengthen information security controls to help ensure that Pubweb meets FISMA requirements. The Director of the Board's Division of Information Technology and the Assistant to the Board, Office of Board Members, stated that they generally agree with the recommendations discussed in the report, and in many cases, corrective action has already been completed or is well underway. We will follow up on the implementation of these recommendations as part of our future FISMA-related audit activities.

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2. The CIGFO working group did not assess whether controls in place were effective or commensurate with risk or determine whether FSOC federal agency members were complying with controls.

3. All FSOC federal agency members are subject to FISMA, which requires that federal agencies review their information and determine appropriate security controls over that information commensurate with risk.

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

During this reporting period, we completed our security control review of the Federal Reserve Bank of Richmond's (FRB Richmond's) Lotus Notes systems supporting the Board's BS&R Division. FRB Richmond's Lotus Notes systems are classified as third-party applications, and they are components of a general support system that is listed on the Board's FISMA application inventory under BS&R. The Lotus Notes systems are used by FRB Richmond to support supervision and examination activities. Our objective was to evaluate the adequacy of selected security controls for protecting data in the Lotus Notes systems from unauthorized access, modification, destruction, or disclosure.

Overall, our review found that a number of actions have been taken to secure the Lotus Notes systems and that associated controls are adequately designed and implemented. We identified opportunities, however, to strengthen information security controls to help ensure that sensitive bank supervision and examination information is protected and that the Lotus Notes systems meet FISMA requirements. In comments on a draft of our report, the Directors of BS&R and the Division of Information Technology generally agreed with our recommendations and outlined corrective actions already taken or underway. We will follow up on the implementation of these recommendations as part of our future FISMA-related audit activities.

Security Control Review of the Aon Hewitt Employee Benefits System

Consistent with the requirements of FISMA, we conducted a security control review of the Aon Hewitt Employee Benefits System. This system provides Board and Federal Reserve Bank staff with the ability to view and manage their employee benefits information through the Internet, and it stores sensitive personally identifiable, health, and financial information. The Aon Hewitt Employee Benefits System is listed on the Board's FISMA inventory as a contractor-operated system, and the Board's Management Division has overall responsibility for ensuring that Board data in the system meet FISMA requirements.

Our audit objective was to evaluate the adequacy of selected security controls for protecting Board data in the Aon Hewitt Employee Benefits System from unauthorized access, modification, destruction, or disclosure. To accomplish this objective, we used a control assessment review program based on the security controls defined in NIST SP 800-53. This document provides a baseline of managerial, operational, and technical security controls for organizations to use in protecting their information systems.

Overall, our review found that a number of actions have been taken to secure the Aon Hewitt Employee Benefits System. We found, however, that significant improvements were needed to ensure that the requirements of the Board's Information Security Program are met. In comments on a draft of our report, the Chief Operating Officer and Director of the Management Division agreed that the report recommendations represented best information security practices consistent with the Board's Information Security Program. The Chief Operating Officer and Director of the Management Division outlined actions that have been taken, are underway, and are planned to strengthen security controls for the Aon Hewitt Employee Benefits System. We will follow up on the implementation of these recommendations as part of our future FISMA-related audit activities.

FOLLOW-UP ACTIVITIES AT THE BOARD

Follow-up on the Audit of the Board's Compliance with Overtime Requirements of the Fair Labor Standards Act

Our March 2007 report on the *Audit of the Board's Compliance with Overtime Requirements of the Fair Labor Standards Act* contained two recommendations designed to enhance controls related to the Fair Labor Standards Act (FLSA) processing as well as to better align the Board's policies and processes with FLSA requirements. Previous follow-up work enabled us to close one of the recommendations. Our final open recommendation was that the Director of the Management Division should enhance FLSA premium pay processing by establishing controls to ensure that all other forms of premium pay are entered before the process is run, establishing controls to ensure the process is run or eliminating the manual intervention required to initiate the process, and correcting the system logic for processing FLSA premium adjustments.

During this follow-up review, we determined that sufficient action had been taken to close the remaining recommendation. The Management Division has determined that manual intervention cannot be eliminated for initiating FLSA premium processing due to the way different elements of payroll are entered into the system. However, the Management Division uses the Payroll checklist to ensure that the FLSA process is run in PeopleSoft. The running of the FLSA process is listed as an item in the General Process section of the checklist. The Management Division stated that FLSA premium adjustments are infrequent, representing small amounts of premium pay, and that the costs of correcting the system logic would outweigh the benefits. Considering that the Management Division has implemented multiple controls to ensure that all forms of premium pay are entered before the FLSA process is run, we are closing this recommendation.

Follow-up on the Audit of the Board's Transportation Subsidy Program

Our March 2011 report on the *Audit of the Board's Transportation Subsidy Program* contained three recommendations designed to help the Board enhance its system of internal controls over the Transportation Subsidy Program (TSP) and minimize the potential for fraud and abuse. We recommended that the Acting Director of the Management Division (1) finalize and issue the draft revised *Transportation Subsidy* policy, which includes control enhancements; (2) update the *Employee Separation Form* and the Board's exit process to ensure that employees separating from the Board are also removed from the TSP; and (3) improve the Board's processes and written procedures to ensure that TSP participants (a) are removed from the program in a timely manner when they separate from the Board so they do not continue to receive benefits, (b) provide the Accounting section with up-to-date address and commuting cost information, and (c) do not also have a parking permit.

Based on our follow-up work, we determined that sufficient action had been taken to close the three recommendations. Specifically, we found that the Management Division finalized and approved the updated *Transportation Subsidy* policy. The updated policy was posted on the Board's intranet website in January 2012. The new policy includes control enhancements requiring subsidy recipients to reduce benefits claimed based on lower commuting costs during periods when employees are out of the office on travel or leave, notify the Accounting section of their withdrawal from the program when separating from the Board, and annually revalidate their TSP applications and continuing eligibility. We also found that the Management Division has taken the necessary steps to ensure that employees separating from the Board are removed from the TSP. In May 2012, the Board implemented the Employee Separation Process Automation for employees separating from the Board as part of the Board's exit process. The *Employee Separation Form* is no longer in use since the implementation of Employee Separation Process Automation. Finally, we found that the Management Division updated the TSP procedures by adding three new sections that specifically address the three components of this recommendation. These sections require that Accounting personnel (1) remove from the program, on a weekly basis, TSP participants separating from the Board; (2) compare TSP participant addresses in the TSP database to addresses in the payroll application and follow up with participants whose addresses do not match to obtain updated TSP forms; and (3) remove TSP participants from TSP if they obtained a lottery, contingency, or permanent parking pass for 10 or more days in a month in which they are receiving TSP benefit.

Follow-up on the Report on the Control Review of the Board's Currency Expenditures and Assessments

During the reporting period, we completed a second follow-up review of our September 2008 *Report on the Control Review of the Board's Currency Expenditures and Assessments.* The report contained five recommendations to the Management Division and one recommendation to the Division of Reserve Bank Operations and Payment Systems (RBOPS) to enhance the Board's currency processes and strengthen the program's controls. Our previous follow-up work resulted in the closure of the five Management Division recommendations. Based on our current follow-up work, we have determined that sufficient action has been taken to close the recommendation to RBOPS. We recommended that the Director of RBOPS establish agreements between the Board and the Bureau of Engraving and Printing to formalize vault operational reviews and develop a mechanism to independently verify the unissued notes inventory. During our review, we found that the Board and the Bureau of Engraving and Printing finalized an updated memorandum of understanding in December 2011 that formalizes the agencies' understanding regarding their respective responsibilities and authorities related to Federal Reserve notes, vault operational reviews, and the verification of unissued notes inventory.

Follow-up on the Audit of the Board's Payroll Process

During the reporting period, we completed a third follow-up review of our December 2006 report on the *Audit of the Board's Payroll Process.* The report contained seven recommendations designed to improve the overall efficiency and accuracy of the Board's payroll processes and to help ensure compliance with applicable laws and regulations. Our previous follow-up work resulted in the closure of three recommendations, as well as the partial closure of two other recommendations that pertained to realigning the roles and responsibilities of the Payroll and Benefits staffs to streamline certain processes, enhancing controls over the payroll application, and establishing specific guidelines for paying overtime to all law enforcement personnel. During the current review, we examined what actions the Management Division has taken to address the remaining four recommendations regarding (1) the redesign of existing payroll processes to increase efficiency and strengthen controls by reducing or eliminating multiple data transcriptions for overtime and other types of premium pay; (2) the increase of the use of automation to allow employees to directly update more information in the Board's payroll application; (3) the development, documentation, and dissemination of procedures for all payroll-related processes; and (4) the Board's withholding of state income taxes for employees who reside and regularly work in locations other than Maryland, Virginia, or the District of Columbia.

Based on our follow-up work, we determined that sufficient action had been taken to close the four remaining recommendations. Specifically, we found that the Management Division (1) implemented Rapid Entry Paysheets, an automated system used to input, review, and approve premium pay, in one of the three remaining areas noted in our report since our prior follow-up and has plans to implement Rapid Entry Paysheets in the other two areas by the end of this year; (2) automated several processes within its payroll application that allow employees to enter information directly into the system and eliminate manual intervention by Payroll staff; (3) completed developing, finalizing, and disseminating procedures for all payroll-related processes since our last follow-up review; and (4) is withholding state income taxes for employees who reside and regularly work in locations other than Maryland, Virginia, or the District of Columbia.

ONGOING AUDIT WORK AT THE BOARD

Audit of the Board's Internal Control Processes

During this reporting period, we continued our audit of the Board's internal control processes across divisions. Our objective is to assess the processes for establishing, maintaining, and monitoring internal controls within the Board. A properly designed and effectively implemented internal control process is intended to provide reasonable assurance that policies are followed and objectives are met; programs achieve their intended results; resource use is consistent with laws, regulations, and policies; and reliable information is obtained, maintained, reported, and used for decisionmaking. We expect to complete our audit during the next semiannual reporting period.

Audit of the Board's Purchase Card Program

During the reporting period, we completed fieldwork and began drafting our report on the audit of the Board's purchase card program. The program is part of a government-wide charge card program administered by the General Services Administration to reduce administrative costs of acquiring low-cost, standard items. The objective for this review is to determine whether controls are in place to prevent fraud and abuse. Specifically, we are evaluating the adequacy of procedures for issuing purchase cards and ensuring proper use and evaluating cardholder's compliance with current Board policies. We expect to complete our review during the next semiannual reporting period.

Study of the Freedom of Information Act Exemption Impact

Section 1103 of the Dodd-Frank Act amends section 11 of the Federal Reserve Act to establish mandatory disclosure dates for information concerning the borrowers and counterparties participating in emergency credit facilities, discount window lending programs, and open market operations that are authorized by the Board. Prior to these mandatory release dates, the Dodd-Frank Act provides that this information is exempt from disclosure under the Freedom of Information Act. As required by the Dodd-Frank Act, we are conducting a study of the impact that this Freedom of Information Act exemption has had on the public's ability to access information about the Board's administration of emergency credit facilities, discount window lending operations, and open market operations. Further, section 11(s)(8)(B) requires that we submit a report to the Senate Committee on Banking, Housing, and Urban Affairs and the House of Representatives Committee on Financial Services on the findings of our study, as well as make any recommendations on whether the exemption in section 11(s) should remain in effect. We will issue our report in January 2013.

Audit of Planning and Contracting for the Martin Building Renovations and Necessary Relocation of Staff

During this reporting period, we began an audit of the Board's planning and contracting process for its Martin Building renovation and relocation of staff. The Martin Building renovation project is one of the Board's largest contracting efforts and will require significant space planning and relocation of staff. During the first phase of this audit, we conducted an audit survey to gather information and gain an understanding of the current status of the Martin Building construction and renovation project, the space planning process, and leasing policies and procedures. We met with officials and staff involved with the project and reviewed applicable policies and procedures, status documents, and other background material. We also attended related meetings and briefings to obtain relevant information. We are currently developing our formal fieldwork objectives and the audit's scope and methodology.

Audit of the Board's Information Security Program

We began our annual audit of the Board's information security program and practices. This audit is being performed pursuant to FISMA, which requires each agency IG to conduct an annual independent evaluation of the agency's information security program and practices. Our specific audit objectives are to evaluate the effectiveness of security controls and techniques for selected information systems and to evaluate compliance by the Board with FISMA and related information security policies, procedures, standards, and guidelines provided by NIST, the Office of Management and Budget, and the Department of Homeland Security. In accordance with reporting requirements, our FISMA review includes an analysis of the Board's security-related processes in the following areas: risk management, continuous monitoring management, plan of action and milestones, identity and access management, remote access management, configuration management, security training, contractor systems, contingency planning, incident response and reporting, and security capital planning. We expect to complete this project and issue our final report in the next reporting period.

Security Control Review of Contingency Planning Controls for the Information Technology General Support System

During this period, we issued for Board comment a draft report on this review. Our audit objective is to determine whether the Division of Information Technology is maintaining a contingency program for its general support system that is generally consistent with NIST and Office of Management and Budget FISMA guidance. To accomplish this objective, we developed a tailored control assessment program based on the security controls defined in NIST SP 800-53. We anticipate issuing our final report in the next reporting period.

Security Control Review of the Commercial Data Exchange Service

During this period, we began a security control review of the Commercial Data Exchange Service. This application is listed on the Board's FISMA inventory as a third-party application maintained by the Federal Reserve Bank of Philadelphia for BS&R. Our review objectives are to (1) evaluate the adequacy of certain control techniques for protecting data in the system from unauthorized access, modification, destruction, or disclosure and (2) assess compliance with the Board's Information Security Program. We expect to complete this project and issue our final report in the next reporting period.

Security Control Review of the National Examination Database System

We continued our fieldwork related to a security control review of the Board's National Examination Database System. The National Examination Database System is a major application of the Board that is utilized by BS&R. Our objectives are to (1) evaluate the adequacy of certain control techniques designed to protect data in the system from unauthorized access, modification, destruction, or disclosure and (2) assess compliance with the Board's Information Security Program and FISMA requirements. We expect to complete the review during the next semiannual reporting period.

Audit of the Board's Financial Statements for the Year Ending December 31, 2012

We contract for an independent public accounting firm to annually perform an integrated audit of the Board's financial statements. The accounting firm, currently Deloitte & Touche LLP, performs the audit to obtain reasonable assurance that the financial statements are free of material misstatement and to express an opinion on the effectiveness of the Board's internal controls over financial reporting based on the Public Company Accounting Oversight Board standards. The OIG oversees the activities of the contractor to ensure compliance with generally accepted government auditing standards and Public Company Accounting Oversight Board auditing standards related to internal controls over financial reporting. The audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The audit also includes an assessment of the accounting principles used and significant estimates made by management, as well as an evaluation of the overall financial statement presentation. As part of obtaining reasonable assurance that the financial statements are free of material misstatement, the auditors also will perform tests of the Board's compliance with certain provisions of laws and regulations, since noncompliance with these provisions could have a direct and material effect on the determination of the financial statement amounts. The audit report will be issued in the next reporting period.

Audit of the Federal Financial Institutions Examination Council's Financial Statements for the Year Ending December 31, 2012

We contract for an independent public accounting firm to annually audit the financial statements of the FFIEC. (The Board performs the accounting function for the FFIEC.) The accounting firm, currently Deloitte & Touche LLP, performs the audits to obtain reasonable assurance that the financial statements are free of material misstatement. The OIG oversees the activities of the contractor to ensure compliance with generally accepted government auditing standards. The audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The audit also includes an assessment of the accounting principles used and significant estimates made by management, as well as an evaluation of the overall financial statement presentation. To determine the auditing procedures necessary to express an opinion on the financial statements, the auditors will consider the FFIEC's internal controls over financial reporting. As part of obtaining reasonable assurance that the financial statements are free of material misstatement, the auditors also will perform tests of the FFIEC's compliance with certain provisions of laws and regulations, since noncompliance with these provisions could have a direct and material effect on the determination of the financial statement amounts. We expect to complete our audit during the next semiannual reporting period.

Audit Survey of BS&R's Supervision of Large Bank Holding Companies and Systemically Important Financial Institutions

During this reporting period, we completed an audit survey and data-gathering effort to review how BS&R is enhancing supervision of the largest, most complex financial firms through the use of analysis and research that provides a macro prudential view. During our survey, we met with officials and staff of the Board's Large Institution Supervision Coordinating Committee with responsibility for evaluating quantitative and qualitative risk assessments and officials and staff of the Office of Financial Stability, which brings an independent, quantitative perspective to the Federal Reserve System's supervision. Based on our survey, we will identify potential future work that will be included in our dynamic planning process.

Inspections and Evaluations

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

COMPLETED INSPECTION AND EVALUATION WORK AT THE BOARD

Failed Bank Reviews

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

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

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

The Dodd-Frank Act also establishes specific requirements for bank failures that result in losses below the materiality threshold. In these situations, the IG must review the failure to determine, among other things, whether the loss exhibits unusual circumstances that warrant an in-depth review. In such cases, the IG must prepare a report in a manner consistent with the requirements of a material loss review. Pursuant to the Dodd-Frank Act, the IG must semiannually report the dates when each such review and report will be completed. If the IG determines that a loss did not involve unusual circumstances that warrant an in-depth review, the IG is required to provide an explanation of its determination in the above-mentioned semiannual report. The OIG has included its report on nonmaterial loss bank failures in this *Semiannual Report to Congress* (page 22).

As shown in the table below, during this reporting period we issued two reports on failed state member banks that had losses to the DIF that exceeded the materiality threshold. These two banks had total assets of approximately $2.3 billion and total losses estimated at $493.3 million, or approximately 21.4 percent of total assets.

Failed Bank Reviews Completed during the Reporting Period

State member bank	Location	Federal Reserve Bank	Asset size (in millions)	DIF projected loss (in millions)	Closure date	FDIC OIG notification date[a]
Bank of the Commonwealth	Norfolk, VA	Richmond	$974.9	$268.3	09/23/2011	10/12/2011
Community Banks of Colorado	Greenwood Village, CO	Kansas City	$1,300.0[b]	$225.0[b]	10/21/2011	11/18/2011

a. Date that our office received notification from the FDIC OIG that the projected loss to the DIF would be material.

b. Approximation.

Bank of the Commonwealth

The FDIC estimated that Bank of the Commonwealth's failure would result in a $268.3 million loss to the DIF, which exceeded the $200 million materiality threshold that applied at the time of notification by the FDIC OIG. Our review sought to determine why the Bank of the Commonwealth's failure resulted in a material loss to the DIF and assessed FRB Richmond's supervision of Bank of the Commonwealth during our period of review, 2000 through 2011.

Bank of the Commonwealth failed because of the convergence of several factors, including corporate governance weaknesses, an aggressive growth strategy that resulted in concentration risk, insufficient credit risk management practices, and pervasive internal control weaknesses. These factors, combined with deteriorating real estate markets, led to rapid asset quality deterioration. Bank of the Commonwealth did not acknowledge the full extent of problem loans in its portfolio and adequately reserve against prospective losses. It also engaged in unsafe and unsound banking practices to mask its financial condition. Mounting losses depleted earnings and eroded capital, which prompted the Commonwealth of Virginia State Corporation Commission, Bureau of Financial Institutions to close the bank and appoint the FDIC as receiver on September 23, 2011.

Our analysis of FRB Richmond's supervision of Bank of the Commonwealth for the review period revealed that examiners identified the bank's fundamental weaknesses but did not take early, forceful supervisory action to address these weaknesses. Additionally, we determined that FRB Richmond did not comply with examination frequency requirements and guidelines for our period of review.

We recommended that the Director of BS&R ensure that FRB Richmond improves its supervisory activities by confirming that examination reports are consistent with *Commercial Bank Examination Manual* standards, assuring staff impartiality, and training FRB Richmond staff on the code of conduct. We also recommended that the Director of BS&R consider creating guidelines outlining when examination supervisors should refer to prior enforcement actions when developing a supervisory strategy for an institution that requires an enforcement action and issue supplemental guidance reiterating the unique circumstances in which a Reserve Bank should file a Suspicious Activity Report. The Division Director stated that BS&R staff concurred with the conclusions, lessons learned, and recommendations in the report.

Community Banks of Colorado

The FDIC estimated that the failure of Community Banks of Colorado would result in approximately a $225 million loss to the DIF, which exceeded the $200 million materiality threshold that applied at the time of notification by the FDIC OIG. Our review sought to determine why Community Banks of Colorado's failure resulted in a material loss to the DIF and assessed the Federal Reserve Bank of Kansas City's (FRB Kansas City's) supervision of Community Banks of Colorado during our period of review, 2007 through 2011.

Community Banks of Colorado failed because its board of directors and management did not adequately control the risks associated with the bank's growth strategy. The bank expanded within Colorado by merging with multiple banks and establishing new branch locations from 2003 to 2007. This strategy significantly increased the bank's commercial real estate (CRE) lending activities, particularly in construction, land, and land development loans. The board of directors' and management's failure to effectively manage Community Banks of Colorado's CRE credit risk, coupled with weakening real estate markets, led to asset quality deterioration. Mounting losses depleted earnings and eroded capital, which prompted the Federal Reserve Board to appoint the FDIC as receiver on October 21, 2011.

FRB Kansas City complied with the examination frequency guidelines and conducted regular off-site monitoring during the period we reviewed. Our analysis of FRB Kansas City's supervision of Community Banks of Colorado revealed that FRB Kansas City identified the bank's heightened credit risk and the potential threat to capital, but should have taken earlier supervisory action to address those issues. While we believe that FRB Kansas City had opportunities for earlier supervisory responses, we could not predict the effectiveness or outcome of any measures that might have been taken. Therefore, we could not evaluate the degree to which an earlier or alternative supervisory response would have affected Community Banks of Colorado's financial deterioration or the ultimate cost to the DIF.

We believe that Community Banks of Colorado's failure offers lessons learned that can be applied to those who supervise banks with similar characteristics and circumstances. Community Banks of Colorado's failure illustrates (1) a bank's vulnerability to changes in real estate markets when the bank's strategy features a high concentration in CRE loans, (2) the importance of a bank timely implementing a robust credit risk management program designed to facilitate the identification and management of concentrations, and (3) the importance of a forward-looking examination approach that assesses various risk factors that could affect a bank's condition. The Director of BS&R concurred with the conclusions and lessons learned in the report.

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

During this reporting period, we evaluated whether staff of the Board or FRB New York had knowledge of or played a role in the unauthorized disclosure of a confidential staff draft of the Volcker Rule NPRM. As part of our review, we also assessed the Board's information-sharing practices for rulemaking activities.

Section 619 of the Dodd-Frank Act, which amends the Bank Holding Company Act of 1956, contains two key prohibitions on the activities of insured depository institutions, BHCs, and their subsidiaries or affiliates. These prohibitions are commonly known as the Volcker Rule.

The Dodd-Frank Act required FSOC to conduct a study and make recommendations for implementing the provisions of section 619. The FSOC study contained 10 recommendations for implementing the Volcker Rule. Section 619 required the Board, the FDIC, the OCC, the SEC, and the CFTC to consider the FSOC study's findings and jointly adopt rules to implement its provisions. This interagency rulemaking team met regularly from January 2011 through October 2011 to jointly develop the Volcker Rule NPRM.

As part of this joint rulemaking process, Board employees distributed several versions of the NPRM to the rulemaking team for deliberation, including a version labeled "confidential staff draft" dated September 30, 2011. On October 5, 2011, *American Banker*, a banking and financial services media outlet, published this nonpublic, confidential staff draft of the NPRM on its website.

Although our review identified several apparent instances of unauthorized disclosures that occurred during the rulemaking process, we did not find any evidence to indicate that these disclosures originated at the Board or at FRB New York. Nonetheless, we identified three recommendations for improving information-sharing controls and procedures for future rulemaking activities.

We provided a copy of our report for review and comment to the Board's General Counsel; the Directors of BS&R, the Division of Research and Statistics, and the Division of Information Technology; and FRB New York's Senior Vice President of Markets. The General Counsel's consolidated official response indicated that "serious consideration" would be given to recommendations 1 and 2 and that actions are being taken to address recommendation 3. We will follow up on actions taken to implement each recommendation.

Inspection of the Board's Protective Services Unit

During this reporting period, we completed our inspection of the Board's Protective Services Unit (PSU). The USA Patriot Act of 2001 granted the Board certain federal law enforcement authorities. To implement these authorities, the Board promulgated the *Uniform Regulations for Federal Reserve Law Enforcement Officers* in 2002. The regulations apply to the Law Enforcement Unit, which safeguards Board-designated property and personnel, and the PSU, which provides physical security for the Board's Chairman 24 hours a day, 7 days a week. The regulations designated the Board's OIG as the External Oversight Function responsible for reviewing and evaluating the Board's law enforcement programs and operations. We performed this inspection of the Board's PSU as part of our external oversight responsibilities.

The objective of this inspection was to provide reasonable assurance that the PSU's operations comply with applicable laws, regulations, and internal policies and procedures and align with law enforcement best practices. Overall, we found that the PSU generally complies with the *Uniform Regulations for Federal Reserve Law Enforcement Officers*, Board and PSU internal policies and procedures, and applicable laws. Notwithstanding the PSU's general compliance with applicable guidance, our inspection found opportunities to improve internal controls that resulted in six recommendations. We presented the inspection results to the Assistant to the Board and the Special Agent in Charge of the PSU, who concurred with our findings and agreed to implement our recommendations.

Transfer of Office of Thrift Supervision Functions

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

The Dodd-Frank Act required that, within 180 days after its enactment, the OTS, the OCC, the FDIC, and the Board jointly submit a plan—the Joint Implementation Plan—to Congress and the IGs of the

Treasury, the FDIC, and the Board that detailed the steps each agency would take to implement the title III provisions. The Joint Implementation Plan was submitted to Congress and the IGs on January 25, 2011. The Dodd-Frank Act required that the IGs conduct a review to determine whether the implementation plan conformed to the title III provisions. On March 28, 2011, the IGs jointly issued a report concluding that the actions described in the Joint Implementation Plan generally conformed to the provisions of title III.[4]

Section 327 of title III requires the IGs to report on the status of the implementation of the Joint Implementation Plan every six months. The IGs have issued three status reports to date: the first on September 28, 2011; the second on March 21, 2012; and, during this reporting period, the third on September 26, 2012. These joint reports, all of which were titled *Status of the Transfer of Office of Thrift Supervision Functions*, concluded that the Board, the FDIC, the OCC, and the OTS have substantially implemented the actions in the plan to transfer OTS functions, employees, funds, and property to the Board, the FDIC, and the OCC, as appropriate. All three reports noted that the Board was still undertaking certain aspects of the plan, and the September 26, 2012, report noted that the rulemaking for the collection of supervisory assessments by the Board was ongoing and not yet required to be completed as provided in title III. In its written comments regarding the September 26, 2012, report, the Board stated that it agreed with the IGs' conclusion.

ONGOING INSPECTION AND EVALUATION WORK AT THE BOARD

Failed Bank Reviews

We are currently conducting two failed bank reviews. These banks had total assets of approximately $1.1 billion and total losses to the DIF estimated at $185.9 million, or approximately 16.9 percent of total assets.

Bank of Whitman

On August 5, 2011, the Washington Department of Financial Institutions closed Bank of Whitman, headquartered in Colfax, Washington. At closure, the FDIC reported that Bank of Whitman had $548.6 million in total assets as of June 30, 2011. On August 5, 2011, the FDIC estimated that the cost of the failure to the DIF would be $134.8 million, which did not meet the materiality threshold as defined under section 38(k) of the FDI Act. However, we determined that Bank of Whitman's failure presents unusual circumstances warranting an in-depth review because, among other factors, (1) senior bank officials allegedly colluded with other banks in a scheme designed to increase capital and (2) a borrower with whom Bank of Whitman had a substantial relationship was allegedly involved in a Ponzi scheme that may have involved the use of bank funds. Examiners cited Bank of Whitman for several instances of exceeding Washington State's legal lending limit, including loans made to this borrower. We expect to issue our report by January 2013.

Waccamaw Bank

On June 8, 2012, the North Carolina Office of the Commissioner of Banks closed Waccamaw Bank and appointed the FDIC as receiver. According to the FDIC's press release, as of March 31, 2012, Waccamaw Bank had approximately $533.1 million in total assets and $472.7 million in total deposits. On June 8, 2012, the FDIC estimated that the cost of Waccamaw Bank's closure to the DIF will be

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

$51.1 million, which did not meet the materiality threshold as defined under section 38(k) of the FDI Act. Based on the results of our failed bank review, we determined that the failure of Waccamaw Bank was due to circumstances that have been covered in past OIG reports. However, our failed bank review also identified three unusual circumstances that warrant an in-depth review of Waccamaw Bank: (1) Waccamaw Bank appears to have misinformed regulators about key aspects of an asset swap transaction that significantly changed its risk profile and financial condition; (2) Waccamaw Bank initiated a series of appeals related to the examiners' recommended accounting treatment of a transaction, which ultimately reached the highest level of appellate review by a Board Governor; and (3) there were unique circumstances surrounding the retirement of Waccamaw Bank's former president and CEO. As a result, we will initiate an in-depth review that focuses on these three unusual circumstances. We plan to issue our report by June 2013.

Review of the Federal Reserve's Supervisory Activities Related to the Recent Loss at JPMorgan Chase & Co.'s Chief Investment Office

During this reporting period, we initiated a scoping review of the Federal Reserve's supervisory activities related to the recent loss at JPMorgan Chase & Co.'s Chief Investment Office. We completed our scoping review and subsequently initiated evaluation work. Our objectives for this evaluation are to (1) assess the effectiveness of the Board's and FRB New York's consolidated and other supervisory activities regarding JPMorgan Chase & Co.'s Chief Investment Office and (2) identify lessons learned for enhancing future supervisory activities.

Evaluation of the Board's Policies, Procedures, and Practices Associated with Conferences

During this reporting period, the OIG initiated an evaluation of the Board's conference-related activities. The evaluation began shortly after the General Services Administration issued a report on a conference held just outside Las Vegas that noted multiple violations of the Federal Travel Regulation. The objectives of our evaluation will focus on determining the controls, policies, procedures, and practices associated with conferences. The review will be limited to conference activities sponsored by the Board. We are in the process of completing our planning and scope development efforts and plan to issue our report during the next semiannual reporting period.

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

During this reporting period, we completed our initial data gathering and continued our fieldwork related to the Board's emergency preparedness for unexpected emergency events. The objective of this review is to evaluate the Board's policies and procedures for responding to unexpected emergency events. As part of this effort, we will assess the Law Enforcement Unit's communication protocols for processing and disseminating information to Board staff during such events. We expect to complete our evaluation during the next semiannual reporting period.

Evaluation of the Board's Adherence to the Small Entity Compliance Guide Requirements in the Small Business Regulatory Fairness Enforcement Act of 1996

During this reporting period, we continued our evaluation of the Board's adherence to the small entity compliance guide requirements contained in the Small Business Regulatory Fairness Enforcement Act of 1996, as amended. On January 26, 2011, the OIG Hotline received a complaint concerning the Board's proposed rule related to mortgage broker compensation. The complaint outlined several concerns related to the Board's rulemaking process for the proposed rule. The complainant mentioned that these concerns had been raised to the Board's "regulatory staff" and Ombudsman and requested that the Board withdraw the proposed rule. One of the observations in the complaint supporting the need to withdraw the rule involved the Board's adherence to the small entity compliance guide requirements contained in the Small Business Regulatory Fairness Enforcement Act of 1996, as amended. The complainant substantiated this claim by providing a memorandum from the Small Business Administration's Office of Advocacy expressing concerns about the Board's Truth in Lending Act compliance guide.

In response to the complaint, representatives from the Board's OIG, Ombudsman, and DCCA met directly with the complainant to discuss the concerns. We initiated this evaluation to assess the Board's compliance with applicable requirements. We anticipate issuing our report before the close of the next semiannual reporting period.

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

The FDI Act, as amended by the Dodd-Frank Act, requires the IG of the appropriate federal banking agency to report, on a semiannual basis, certain information on financial institutions that incurred nonmaterial losses to the DIF and that failed during the respective six-month period. As shown in the table below, three failed state member banks had losses to the DIF that did not meet the materiality threshold requiring an OIG review, which currently is a loss in excess of $150.0 million. These institutions had total assets of approximately $974.8 million and losses estimated at $131.8 million, or 13.5 percent of total assets.

When bank failures result in nonmaterial losses to the DIF, the IG is required to determine (1) the grounds identified by the federal banking agency or the state bank supervisor for appointing the FDIC as receiver[5] and (2) whether the losses to the DIF present unusual circumstances that would warrant an in-depth review. If an in-depth review is not warranted, the IG is required to provide an explanation of its determination.

We reviewed the state member bank failures to determine whether the resulting losses to the DIF exhibited unusual circumstances that would warrant an in-depth review. In general, we considered a loss to the DIF to present unusual circumstances if the conditions associated with the bank's deterioration, ultimate closure, and supervision were not addressed in any of our prior bank failure reports or involved potential fraudulent activity. To make this determination, we analyzed key data from the five-year period preceding the bank's closure. These data generally comprised Federal Reserve Bank and state examination schedules; Reports of Examination, including CAMELS ratings[6] and financial data; informal and formal enforcement actions and other supervisory activities, such as visitations; and prompt corrective action determinations. As shown in the below table, we determined that the Waccamaw Bank failure exhibited unusual circumstances warranting an in-depth review.

Nonmaterial State Member Bank Failures during the Reporting Period

State member bank	Location	Asset size (in millions)	DIF projected loss (in millions)	Closure date	OIG summary of state's grounds for receivership	OIG determination
Bank of the Eastern Shore	Cambridge, MD	$164.1	$43.7	04/27/2012	Best interest of the bank and its depositors	Circumstances do not warrant an in-depth review
Waccamaw Bank	Whiteville, NC	$536.3	$51.4	06/08/2012	Troubled condition	Unusual circumstances identified; report to be issued by June 2013
Truman Bank	Clayton, MO	$274.4	$36.7	09/14/2012	Insolvency was inevitable and no prospects for recovery	Circumstances do not warrant an in-depth review

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

6. The CAMELS acronym represents six components: **c**apital adequacy, **a**sset quality, **m**anagement practices, **e**arnings performance, **l**iquidity position, and **s**ensitivity to market risk.

Consumer Financial Protection Bureau

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

COMPLETED WORK

Evaluation of the Consumer Financial Protection Bureau's Consumer Response Unit

During this reporting period, we completed a review of the CFPB's Consumer Response unit. The Dodd-Frank Act mandated that the CFPB "establish a unit whose functions shall include establishing a single, toll-free telephone number, a website, and a database . . . to facilitate the centralized collection of, monitoring of, and response to consumer complaints regarding consumer financial products or services" offered by the companies under its jurisdiction.[7] The Dodd-Frank Act also requires that the CFPB coordinate with other federal agencies to appropriately process complaints.[8] To satisfy the Dodd-Frank Act's requirements for processing consumer complaints, the CFPB created the Consumer Response unit. Our objectives were to (1) evaluate the process the CFPB has established to receive, respond to, and track consumer complaints; (2) assess the CFPB's coordination with federal and state agencies regarding the processing and referral of complaints; and (3) determine the extent to which the CFPB is assessing its effectiveness and timeliness in responding to consumer complaints.

Our analysis determined that the CFPB has a reasonable process to receive, respond to, and track consumer complaints. In addition, the CFPB's consumer response process generally complies with Dodd-Frank Act requirements, the Privacy Act, and industry best practices. The CFPB has a comprehensive manual of standard operating procedures for processing complaints. The manual includes internal controls to mitigate risk in processing consumer complaints. Further, no issues came to our attention to indicate noncompliance with or internal control weaknesses related to the size and nature of the Consumer Response unit's organizational structure, oversight of its contracted contact centers, communication within the Consumer Response unit and throughout the CFPB, coordination with other regulatory agencies for complaint referrals, and the CFPB's schedule for the incremental acceptance of complaints by financial product.

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7. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1013(b)(3)(A), 124 Stat. 1376, 1969 (2010) (codified at 12 U.S.C. § 5493(b)(3)(A) (2010)).

8. The Dodd-Frank Act requires the CFPB to enter into a memorandum of understanding with "any affected Federal regulatory agency regarding procedures by which any covered person, and the prudential regulators, and any other agency having jurisdiction over a covered person, including the Secretary of the Department of Housing and Urban Development and the Secretary of Education, shall comply with this section." Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1034(d), 124 Stat. 1376, 2009 (2010) (codified at 12 U.S.C. § 5534(d) (2010)). The term "covered person" is defined as "any person that engages in offering or providing a consumer financial product or service," as well as any affiliate thereof if the affiliate acts as a service provider to such person. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1002(6), 124 Stat. 1376, 1956 (2010) (codified at 12 U.S.C. § 5481(6) (2010)).

However, our review did note areas in which the CFPB can improve processes and strengthen controls in the Consumer Response unit. Our report contained recommendations to address (1) the inaccurate manual data entry of consumer complaints, (2) the inconsistency of complaint management system data, (3) the lack of a finalized agency-wide privacy policy, (4) the lack of a comprehensive quality assurance program, and (5) the lack of a centralized tracking system for quality assurance reviews. The Assistant Director of the Consumer Response unit agreed with our recommendations and specified actions that have been taken, are underway, or are planned to implement them.

ONGOING WORK

Evaluation of the CFPB's Contract Solicitation and Selection Process

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

Evaluation of the CFPB's Annual Budget Process

During this reporting period, we initiated fieldwork and began assessing the CFPB's annual budget process. As an independent bureau within the Federal Reserve System, the CFPB is funded principally by the Federal Reserve System in amounts determined by the CFPB Director as necessary to carry out the agency's operations, subject to limits established in the Dodd-Frank Act. These transferred funds are not subject to the congressional appropriations process. The CFPB prepared and publicly issued budget documents for fiscal years 2012 and 2013, which contained budgeted amounts of $356 million and $448 million, respectively. Our objective for this review is to evaluate the extent to which the CFPB's budget process facilitates the achievement of the agency's goals and performance objectives and demonstrates the agency's commitment to transparency. We plan to complete our evaluation during the next semiannual reporting period.

Evaluation of the CFPB's Policies, Procedures, and Practices Associated with Conferences

During this reporting period, the OIG initiated an evaluation of the CFPB's conference-related activities. The evaluation began shortly after the General Services Administration issued a report on a conference held just outside Las Vegas that noted multiple violations of the Federal Travel Regulation. The objectives of our evaluation will focus on determining the controls, policies, procedures, and practices associated with conferences. This review will cover both agency-sponsored and nonsponsored conferences. We are in the process of completing our planning and scope development efforts and plan to issue our report during the next semiannual reporting period.

2012 Audit of the CFPB's Information Security Program

During this reporting period, we completed our fieldwork and began drafting the report for our annual review of the CFPB's Information Security Program. This audit is being performed pursuant to FISMA, which requires each agency IG to conduct an annual independent evaluation of the agency's information security program and practices. Our specific audit objectives are to evaluate the effectiveness of security controls and techniques for selected information systems and to evaluate compliance by the CFPB with FISMA and related information security policies, procedures, standards, and guidelines provided by NIST, the Office of Management and Budget, and the Department of Homeland Security. In accordance with reporting requirements, our FISMA review includes an analysis of the CFPB's security-related processes in the following areas: risk management, continuous monitoring management, plan of action and milestones, identity and access management, remote access management, configuration management, security training, contractor systems, contingency planning, incident response and reporting, and security capital planning. We expect to complete this project and issue our final report in the next reporting period.

Security Control Review of the Consumer Response System

During this reporting period, we completed our fieldwork and began drafting the report for our audit of select security controls for the CFPB's Consumer Response System. The Consumer Response System is used by the CFPB to collect, investigate, and respond to consumer complaints regarding certain financial products and services. Our audit objective is to evaluate the adequacy of selected security controls and techniques for protecting data in the system from unauthorized access, modification, destruction, or disclosure. We expect to complete our review during the next semiannual reporting period.

Investigations

The OIG's Investigations office conducts criminal, civil, and administrative investigations related to Board and CFPB programs and operations. The OIG operates under statutory law enforcement authority granted by the U.S. Attorney General, which vests our special agents with the authority to carry firearms, make arrests without a warrant, seek and execute search and arrest warrants, and seize evidence. OIG investigations are conducted in compliance with CIGIE's *Quality Standards for Investigations*.

INVESTIGATIVE ACTIVITIES

During this reporting period, we opened 9 cases, closed 4 cases, and ended the period with 48 investigations in progress. Due to the sensitivity of these investigations, we only report on activities that have resulted in criminal, civil, or administrative action. The following summaries highlight our significant investigative activity during this semiannual reporting period.

Former President and Chief Executive Officer of Orion Bank Sentenced to 72 Months in Prison

During the reporting period, the president and chief executive officer of Orion Bank, Naples, Florida, was sentenced to 72 months in prison and ordered to pay $36,813,765 in restitution for conspiring to commit bank fraud, misapplying bank funds, making false entries in the bank's books and records, and obstructing a bank examination. The charges relate to his role in a scheme to lend $82 million to "straw" borrowers acting on behalf of an Orion Bank borrower (hereafter referred to as the initial borrower) who had reached the bank's legal lending limit. Additionally, the loans concealed $15 million in bank funds to be used for the purchase of Orion stock by the initial borrower, in violation of banking laws and regulations. Orion Bank proceeded to fund the loan transactions even though bank executives, including the president, became aware prior to loan closing that the initial borrower's entire loan relationship was based on fraudulent financial documents.

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

As we previously reported, two senior loan officers are currently serving 24 and 30 months, respectively, for their roles in the conspiracy and were ordered to jointly and severally pay $33,512,618 in restitution. Additionally, the initial borrower is currently serving 65 months in prison and was ordered to pay $65,214,419 in restitution.

This was a joint investigation by the Federal Bureau of Investigation (FBI), the Internal Revenue Service–Criminal Investigation, the FDIC OIG, the Special Inspector General for the Troubled Asset Relief Program, and the Board's OIG. The case was prosecuted by the U.S. Attorney's Office for the Middle District of Florida.

Nine Individuals Enter Guilty Pleas in Connection with Money Laundering Case

During the reporting period, nine individuals entered guilty pleas to various counts of conspiracy, misprision of felony, bank fraud, fraudulent and misuse of immigration documents, and money laundering in U.S. District Court for the Western District of North Carolina.

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

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

This is a joint investigation by the Bureau of Alcohol, Tobacco, Firearms, and Explosives; the Internal Revenue Service–Criminal Investigation; the U.S. Diplomatic Security Service; the Charlotte Mecklenburg Police Department; the Treasury OIG; and the Board's OIG. The case is being prosecuted by the U.S. Attorney's Office for the Western District of North Carolina.

Business Owner Pleads Guilty to Bank Fraud

On August 20, 2012, the former owner of an Illinois agricultural business pleaded guilty to one count of bank fraud in U.S. District Court for the Eastern District of Missouri. The OIG initiated this investigation in January 2010 after receiving information alleging loan fraud at Peoples Bank and Trust, a Board-regulated institution located in Troy, Missouri. According to the allegation, the former owner of the agricultural business executed a fraudulent promissory note in the amount of $10 million with Peoples Bank and Trust.

According to the indictment, from 2006 to 2008, the business owner obtained a substantial amount of financing from Corn Belt Bank, an FDIC-regulated institution. In May 2008, when Corn Belt Bank was no longer able to provide sufficient financial support, the owner arranged for financing with

Peoples Bank and Trust, which included a $10 million line of credit. The purposes of the loan associated with the line of credit included financing the business's operations and paying off a prior loan from Corn Belt Bank. Corn Belt Bank purchased a 20 percent participation in the new loan. In February 2009, Corn Belt Bank was placed into receivership.

The indictment alleged that the business owner provided false information to Peoples Bank and Trust in order to secure the $10 million line of credit. As part of the loan process, the owner provided fraudulent reports regarding the financial position of his business and the status of collateral, including his accounts receivable, so that Peoples Bank and Trust would approve and fund the $10 million line of credit. The indictment further alleged that, after the line of credit was approved and funded, the owner continued to provide false information to Peoples Bank. Ultimately, the business defaulted on the loan, resulting in a loss of most of the $10 million that Peoples Bank and Trust loaned to the business.

We conducted this investigation with the FBI and the FDIC OIG. The case was prosecuted by the U.S. Attorney's Office for the Eastern District of Missouri. Sentencing is scheduled for November 19, 2012.

Missing Georgia Bank Director Indicted for Bank Fraud

On July 11, 2012, a former bank director of Montgomery Bank and Trust, Ailey, Georgia, was indicted by a federal grand jury in U.S. District Court for the Southern District of Georgia on one count of bank fraud. The charges stem from the former bank director defrauding Montgomery Bank and Trust of over $21 million. The OIG initiated this investigation based on a request by the U.S. Attorney's Office, Southern District of Georgia. Montgomery Bank and Trust was a wholly owned subsidiary of Montgomery County Bankshares Inc., a Board-regulated bank holding company.

According to the allegations in the indictment, in 2010 an investment group controlled by the former banker invested approximately $10 million in the failing Montgomery Bank and Trust. The investment group raised the money through the sale of common stock in a newly created subsidiary and a private placement with other investors. As a result of the investment, the former banker was appointed as director of the bank and a newly created subsidiary of the bank and was placed in charge of investing Montgomery Bank and Trust's capital. Over the next 18 months, the former bank director stole, misappropriated, and embezzled over $21 million from Montgomery Bank and Trust. To cover up this fraud, the former bank director provided Montgomery Bank and Trust officials with fraudulent account statements that falsely indicated that the bank's capital was safely held in an account at a financial services firm. As a result of the director's alleged fraud, Montgomery Bank and Trust's cash assets and reserves were depleted. On July 6, 2012, Georgia regulators closed Montgomery Bank and Trust and appointed the FDIC as receiver.

We are jointly conducting this investigation with the FBI and the FDIC OIG. The case is being prosecuted by the U.S. Attorney's Office for the Southern District of Georgia.

Summary Statistics on Investigations during the Reporting Period[a]

Investigative actions	Number
Investigative Caseload	
Investigations Open at End of Previous Reporting Period	43
Investigations Opened during Reporting Period	9
Investigations Closed during Reporting Period	4
Total Investigations Open at End of Reporting Period	48
Investigative Results for Reporting Period	
Referred to Prosecutor	3
Joint Investigations	46
Referred for Audit	0
Referred for Administrative Action	0
Oral and/or Written Reprimands	0
Terminations of Employment	0
Arrests	5
Suspensions	0
Debarments	0
Indictments	6
Criminal Information	0
Convictions	9
Monetary Recoveries	$0
Civil Actions (Fines and Restitution)	$0
Criminal Fines, Restitution, and Forfeitures	$36,814,065

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

HOTLINE ACTIVITIES

To report fraud, waste, abuse, or mismanagement related to the programs or operations of the Board or the CFPB, individuals may contact the OIG Hotline by mail, telephone, fax, or e-mail. Hotline staff analyzes all incoming complaints and, as appropriate, coordinates with OIG and/or other federal staff. During this reporting period, the Hotline received 261 complaints.

The OIG Hotline continued to receive a number of complaints from individuals seeking information about or wanting to file noncriminal consumer complaints against financial institutions. After analyzing these complaints, Hotline staff will typically refer the complaint to the consumer group of the appropriate federal regulator for the institution involved, such as the Customer Assistance Group of the OCC or the CFPB's Consumer Response unit. Beginning in January 2012, CFPB's Consumer Response unit began accepting mortgage complaints from consumers. Since then, the group has expanded to accept complaints about student loans and other consumer financial products and services.

The OIG continued to receive a significant number of complaints involving "spam" or "phishing" e-mails claiming to be from the Federal Reserve. Hotline staff continues to advise all individuals that these suspicious e-mails are solicitations that attempt to obtain the personal and/or financial information of the recipient and that neither the Board nor the Federal Reserve Banks endorse or have any involvement in them. As appropriate, the OIG may investigate these complaints.

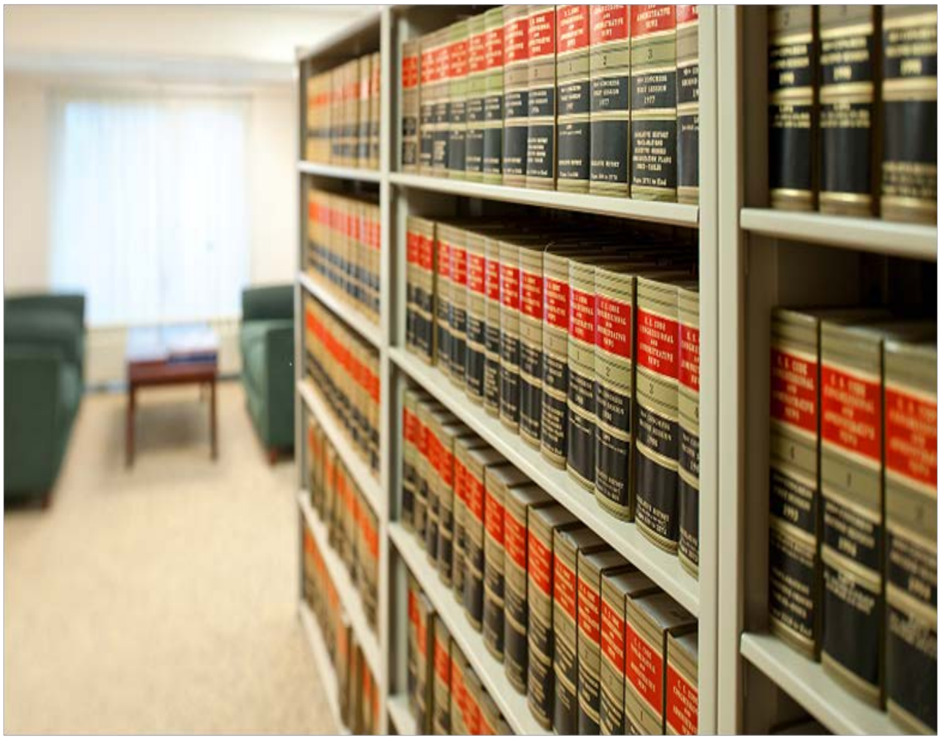
Summary Statistics on Hotline Activities during the Reporting Period

Hotline complaints	Number
Complaints Pending from Previous Reporting Period	8
Complaints Received during Reporting Period	261
Total Complaints for Reporting Period	269
Complaints Resolved during Reporting Period	263
Complaints Pending	6

Legal Services

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

In accordance with section 4(a)(2) of the IG Act, the Legal Services staff conducts an independent review of newly enacted and proposed legislation and regulations to determine their potential effect on the economy and efficiency of the Board's and the CFPB's programs and operations. During this reporting period, Legal Services reviewed 13 legislative and 6 regulatory items.



Communications and Coordination

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

Congressional Coordination and Testimony

The OIG communicates and coordinates with various congressional committees on issues of mutual interest. During the reporting period, we provided 19 responses to congressional members and staff concerning the Board and the CFPB.

Council of Inspectors General on Financial Oversight

Consistent with the Dodd-Frank Act, CIGFO is required to meet at least quarterly to facilitate the sharing of information among the IGs and to discuss the ongoing work of each IG, with a focus on concerns that may apply to the broader financial sector and ways to improve financial oversight. During this reporting period, CIGFO met on May 21 and September 18, 2012. The Treasury IG chairs CIGFO. The Dodd-Frank Act authorizes CIGFO, by a majority vote, to convene a working group to evaluate the effectiveness and internal operations of FSOC. As discussed on page 7, a CIGFO working group identified the controls and protocols that FSOC and its member agencies have implemented to properly safeguard sensitive FSOC-related information. The CIGFO working group identified differences in how FSOC federal agency members mark and handle non-public information. However, the working group found that the FSOC Data Committee is coordinating a project to begin to address the differences among its members and that FSOC is developing tools to support secure collaboration. Given the evolving nature of FSOC and the information coordination projects underway, the report did not include recommendations.

In addition, CIGFO is required to annually issue a report that highlights the IGs' concerns and recommendations, as well as issues that may apply to the broader financial sector. CIGFO issued its second annual report in July 2012.

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

The IG serves as a member of CIGIE, which provides a forum for IGs from various government agencies to discuss government-wide issues and shared concerns. Collectively, the members of CIGIE help improve government programs and operations. The IG also serves as a member of CIGIE's Legislation Committee and Inspection and Evaluation Committee, and he leads the Information

Technology Subcommittee of the Legislation Committee. The Legislation Committee is the central point of information regarding legislative initiatives and congressional activities that may affect the IG community, such as proposed cybersecurity legislation that was reviewed during the reporting period. The Inspection and Evaluation Committee provides leadership for the inspection and evaluation community's efforts to improve agency program effectiveness by maintaining professional standards, leading the development of protocols for reviewing management issues that cut across departments and agencies, promoting the use of advanced program evaluation techniques, and fostering awareness of evaluation and inspection practices in OIGs.

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

Financial Regulatory Coordination

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

Appendixes

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

Reports	Number	Dollar value
For which no management decision had been made by the commencement of the reporting period	0	$0
That were issued during the reporting period	0	$0
For which a management decision was made during the reporting period	0	$0
(i) dollar value of recommendations that were agreed to by management	0	$0
(ii) dollar value of recommendations that were not agreed to by management	0	$0
For which no management decision had been made by the end of the reporting period	0	$0
For which no management decision was made within six months of issuance	0	$0

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

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

Reports	Number	Dollar value
For which no management decision had been made by the commencement of the reporting period	0	$0
That were issued during the reporting period	0	$0
For which a management decision was made during the reporting period	0	$0
(i) dollar value of recommendations that were agreed to by management	0	$0
(ii) dollar value of recommendations that were not agreed to by management	0	$0
For which no management decision had been made by the end of the reporting period	0	$0
For which no management decision was made within six months of issuance	0	$0

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

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

Reports	Number	Dollar value
For which no management decision had been made by the commencement of the reporting period	0	$0
That were issued during the reporting period	0	$0
For which a management decision was made during the reporting period	0	$0
(i) dollar value of recommendations that were agreed to by management	0	$0
(ii) dollar value of recommendations that were not agreed to by management	0	$0
For which no management decision had been made by the end of the reporting period	0	$0
For which no management decision was made within six months of issuance	0	$0

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

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

Reports	Number	Dollar value
For which no management decision had been made by the commencement of the reporting period	0	$0
That were issued during the reporting period	0	$0
For which a management decision was made during the reporting period	0	$0
(i) dollar value of recommendations that were agreed to by management	0	$0
(ii) dollar value of recommendations that were not agreed to by management	0	$0
For which no management decision had been made by the end of the reporting period	0	$0
For which no management decision was made within six months of issuance	0	$0

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

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

Report title	Issue date	Recommendations			Status of recommendations		
		No.	Mgmt. agrees	Mgmt. disagrees	Last follow-up date	Closed	Open
Evaluation of Service Credit Computations	08/05	3	3	–	03/07	1	2
Audit of the Board's Payroll Process	12/06	7	7	–	09/12	7	–
Security Control Review of the Internet Electronic Submission System (Nonpublic Report)	02/07	13	13	–	09/09	12	1
Audit of the Board's Compliance with Overtime Requirements of the Fair Labor Standards Act	03/07	2	2	–	09/12	2	–
Security Control Review of the FISMA Assets Maintained by FRB Boston (Nonpublic Report)	09/08	11	11	–	09/11	10	1
Evaluation of Data Flows for Board Employee Data Received by OEB and Its Contractors (Nonpublic Report)	09/08	2	2	–	03/11	1	1
Report on the Control Review of the Board's Currency Expenditures and Assessments	09/08	6	6	–	09/12	6	–
Audit of Blackberry and Cell Phone Internal Controls	03/09	3	3	–	09/11	2	1
Security Control Review of the Audit Logging Provided by the Information Technology General Support System (Nonpublic Report)	03/09	4	4	–	09/11	3	1
Security Control Review of the Lotus Notes and Lotus Domino Infrastructure (Nonpublic Report)	06/10	10	10	–	–	–	10
Security Control Review of the Internet Electronic Submission System (Nonpublic Report)	12/10	6	6	–	–	–	6
Audit of the Board's Transportation Subsidy Program	03/11	3	3	–	09/12	3	–
Response to a Congressional Request Regarding the Economic Analysis Associated with Specified Rulemakings	06/11	2	2	–	–	–	2
Review of the Failure of Pierce Commercial Bank	09/11	2	2	–	–	–	2
Security Control Review of the Visitor Registration System (Nonpublic Report)	09/11	10	10	–	–	–	10
Summary Analysis of Failed Bank Reviews	09/11	3	3	–	–	–	3
Evaluation of Prompt Regulatory Action Implementation	09/11	1[b]	1	–	–	–	1
Audit of the Board's Information Security Program	11/11	1	1	–	–	–	1
Review of RBOPS' Oversight of the Next Generation $100 Note	01/12	2	2	–	–	–	2
Security Control Review of the National Remote Access Services System (Nonpublic Report)	03/12	8	8	–	–	–	8
Material Loss Review of the Bank of the Commonwealth	04/12	4	4	–	–	–	4
Security Control Review of the Board's Public Website (Nonpublic Report)	04/12	12	12	–	–	–	12
Review of the Unauthorized Disclosure of a Confidential Staff Draft of the Volcker Rule Notice of Proposed Rulemaking	07/12	3	3	–	–	–	3

Report title	Issue date	Recommendations			Status of recommendations		
		No.	Mgmt. agrees	Mgmt. disagrees	Last follow-up date	Closed	Open
Security Control Review of the Federal Reserve Bank of Richmond's Lotus Notes Systems Supporting the Board's Division of Banking Supervision and Regulation (Nonpublic Report)	08/12	9	9	–	–	–	9
Inspection of the Board's Protective Services Unit (Nonpublic Report)	08/12	6	6	–	–	–	6
Audit of the Small Community Bank Examination Process	08/12	1	1	–	–	–	1
Audit of the Board's Government Travel Card Program	09/12	4	4	–	–	–	4
Audit of the Board's Actions to Analyze Mortgage Foreclosure Processing Risks	09/12	2	2	–	–	–	2
Security Control Review of the Aon Hewitt Employee Benefits System (Nonpublic Report)	09/12	8	8	–	–	–	8

a. A recommendation is closed if (1) the corrective action has been taken; (2) the recommendation is no longer applicable; or (3) the appropriate oversight committee or administrator has determined, after reviewing the position of the OIG and division management, that no further action by the agency is warranted. A recommendation is open if (1) division management agrees with the recommendation and is in the process of taking corrective action or (2) division management disagrees with the recommendation and we have referred or are referring it to the appropriate oversight committee or administrator for a final decision.

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

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

Report title	Issue date	Recommendations			Status of recommendations		
		No.	Mgmt. agrees	Mgmt. disagrees	Last follow-up date	Closed	Open
Evaluation of the Consumer Financial Protection Bureau's Consumer Response Unit	09/12	5	5	–	–	–	5

a. A recommendation is closed if (1) the corrective action has been taken; (2) the recommendation is no longer applicable; or (3) the appropriate oversight committee or administrator has determined, after reviewing the position of the OIG and division management, that no further action by the agency is warranted. A recommendation is open if (1) division management agrees with the recommendation and is in the process of taking corrective action or (2) division management disagrees with the recommendation and we have referred or are referring it to the appropriate oversight committee or administrator for a final decision.

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

Title	Type of report
Reviews of Bank Failures	
Material Loss Review of the Bank of the Commonwealth	Evaluation
Material Loss Review of Community Banks of Colorado	Evaluation
Information Technology Audits	
Security Control Review of the Board's Public Website (Nonpublic Report)	Audit
Security Control Review of the Federal Reserve Bank of Richmond's Lotus Notes Systems Supporting the Board's Division of Banking Supervision and Regulation (Nonpublic Report)	Audit
Security Control Review of the Aon Hewitt Employee Benefits System (Nonpublic Report)	Audit
Program Audits, Inspections, and Evaluations	
Audit of the Board's Progress in Developing Enhanced Prudential Standards	Audit
Review of the Unauthorized Disclosure of a Confidential Staff Draft of the Volcker Rule Notice of Proposed Rulemaking	Evaluation
Inspection of the Board's Protective Services Unit (Nonpublic Report)	Inspection
Audit of the Small Community Bank Examination Process	Audit
Audit of the Board's Government Travel Card Program	Audit
Status of the Transfer of Office of Thrift Supervision Functions	Evaluation
Audit of the Board's Actions to Analyze Mortgage Foreclosure Processing Risks	Audit

Total Number of Audit Reports: 7
Total Number of Inspection and Evaluation Reports: 5

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

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

Title	Type of report
Program Audits, Inspections, and Evaluations	
Evaluation of the Consumer Financial Protection Bureau's Consumer Response Unit	Evaluation

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

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

Appendix 5
OIG Peer Reviews

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

- The last peer review of the OIG's audit organization was completed in December 2011 by the Pension Benefit Guaranty Corporation OIG. We received a peer review rating of *pass*. There were no report recommendations, nor were any peer review recommendations pending from any previous peer reviews of our audit organization.

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

- During this reporting period, we completed a peer review of the Office of Personnel Management's (OPM's) OIG audit organization. We found that the system of quality control for the audit organization of the OPM OIG in effect for the year ended March 31, 2012, has been suitably designed and complied with to provide the OPM OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. The OPM OIG has received a peer review rating of *pass*. Our system review report made no recommendations, and the previous peer review for the OPM OIG made no recommendations.

- During this reporting period, we conducted a review of the system of internal safeguards and management procedures in effect during May 1, 2011, through May 18, 2012, for the investigative functions of the OIG for the Corporation for National and Community Service (CNCS). Our review was conducted in conformity with CIGIE and Attorney General guidelines, as applicable. In our opinion, the system of internal safeguards and management procedures for the investigative function of the CNCS OIG in effect during the period May 1, 2011, through May 18, 2012, is compliant with the quality standards established by CIGIE and the applicable Attorney General guidelines. These safeguards and procedures provide reasonable assurance of the CNCS OIG's conformance with professional standards in the planning, execution, and reporting of its investigations. On October 1, 2012, CNCS formally responded to the peer review report and concurred with our observations for suggested improvements. We plan to issue our peer review report by mid-October. There were no open recommendations for CNCS OIG from prior peer reviews.

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

Appendix 6
Index of IG Act Reporting Requirements

Section	Subject	Page(s)
4(a)(2)	Review of legislation and regulations	31
5(a)(1)	Significant problems, abuses, and deficiencies	None
5(a)(2)	Recommendations with respect to significant problems	None
5(a)(3)	Significant recommendations described in previous semiannual reports on which corrective action has not been completed	None
5(a)(4)	Matters referred to prosecutorial authorities	29
5(a)(5); 6(b)(2)	Summary of instances where information was refused	None
5(a)(6)	List of audit, inspection, and evaluation reports	38
5(a)(7)	Summary of particularly significant reports	None
5(a)(8)	Statistical table of questioned costs	34
5(a)(9)	Statistical table of recommendations that funds be put to better use	35
5(a)(10)	Summary of audit, inspection, and evaluation reports issued before the commencement of the reporting period for which no management decision has been made	None
5(a)(11)	Significant revised management decisions made during the reporting period	None
5(a)(12)	Significant management decisions with which the Inspector General is in disagreement	None
5(a)(14), (15), and (16)	Peer review summary	39

Abbreviations

Abbreviation	Description
BHC	Bank Holding Company
Board	Board of Governors of the Federal Reserve System
BS&R	Division of Banking Supervision and Regulation
CFPB	Consumer Financial Protection Bureau
CFTC	Commodity Futures Trading Commission
CIGFO	Council of Inspectors General on Financial Oversight
CIGIE	Council of the Inspectors General on Integrity and Efficiency
CNCS	Corporation for National and Community Service
CRE	Commercial Real Estate
DCCA	Division of Consumer and Community Affairs
DIF	Deposit Insurance Fund
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
FBI	Federal Bureau of Investigation
FDI Act	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FISMA	Federal Information Security Management Act of 2002
FLSA	Fair Labor Standards Act
FRB Kansas City	Federal Reserve Bank of Kansas City
FRB New York	Federal Reserve Bank of New York
FRB Richmond	Federal Reserve Bank of Richmond
FSOC	Financial Stability Oversight Council
GTC	Government Travel Card
IG	Inspector General
IG Act	Inspector General Act of 1978, as amended
NCUA	National Credit Union Administration
NIST	National Institute of Standards and Technology
NPRM	Notice of Proposed Rulemaking
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
OPM	Office of Personnel Management

Abbreviation	Description
OTS	Office of Thrift Supervision
PSU	Protective Services Unit
Pubweb	Public Website
RBOPS	Division of Reserve Bank Operations and Payment Systems
SEC	Securities and Exchange Commission
SP 800-53	Special Publication 800-53, Recommended Security Controls for Federal Information Systems and Organizations
Treasury	U.S. Department of the Treasury
TSP	Transportation Subsidy Program

Office of Inspector General

Board of Governors of the Federal Reserve System
Consumer Financial Protection Bureau

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