

**For release on delivery**

**Statement by**

**George W. Mitchell**

**Vice Chairman, Board of Governors of the Federal Reserve System**

**before the**

**Committee on Banking and Currency**

**House of Representatives**

**October 3, 1973**

Mr. Chairman and members of the Committee, I welcome the opportunity you have afforded me to discuss H. R. 10265, a bill which would amend the Federal Reserve Act in various respects.

Section 1 of the bill would authorize the General Accounting Office to conduct an annual audit of the Board of Governors, the Federal Reserve Banks, and their branches. In so doing, the Comptroller General would be accorded access to such records, including reports of examinations of member banks, as he finds necessary for the conduct of the audits. The Comptroller General would be required to submit a report of each audit to Congress.

Section 2 of the bill would extend the authority of the Reserve Banks to purchase obligations of the United States directly from the Treasury. The Banks are currently permitted to purchase up to \$5 billion of U. S. Government obligations in this manner, but this authority expires on October 31.

Section 3 of the bill would raise by \$60 million the ceiling on expenditures which the Federal Reserve System may undertake for the construction and renovation of branch bank buildings.

The Board supports the objectives of sections 2 and 3; I shall comment on these provisions briefly at the end of my statement.

As we understand section 1, the Comptroller General would be granted broad authority to look into the financial and operational aspects of the Federal Reserve System. The GAO would be unrestricted in the

conduct of the audit, and would thus have the authority to review and evaluate all aspects of Federal Reserve activities.

The Board of Governors over the years has consistently opposed such proposals. It is understandable that some members of Congress and the public have wondered at this, since the General Accounting Office enjoys a well-deserved reputation for competence and integrity. I submit to you, today, however, that we perceive serious problems with this proposal. Our objections stem from a basic concern about the optimal functioning of the nation's money and banking system. With your permission, I'd like to briefly sketch in the background on this subject.

Congress created the GAO in 1921--eight years after passing the Federal Reserve Act--to provide the legislative branch with audit authority over the receipt, disbursement, and application of public funds. For the next twelve years, the Board of Governors, but not the Federal Reserve Banks and branches, came under the GAO's scrutiny. During this time, the accounts of the Board were carefully checked by GAO.

In 1933, however, Congress deliberately voted to remove the Board from the jurisdiction of the GAO. The purpose, as described in the report of the Senate Banking and Currency Committee, was to "leave to the Board the determination of its own internal management policies." This action, we believe, resulted from a judgment that non-interference with the internal management of the Federal Reserve would in the long run provide better monetary and credit policies.

Naturally, the audit function did not cease with the termination of the GAO's annual audits of the Board. For some years, audit teams from nearby Federal Reserve Banks performed the audit of the Board's books, but in 1952, the Board, using the discretion Congress provided, voted to hire nationally-recognized public accounting firms to perform this function in order to assure an independent oversight of the Board's administrative activities. This arrangement has continued to this day. Meanwhile, year in and year out, the Board's own examiners scrutinized the Federal Reserve Banks. In recent years, their techniques have been reviewed by outside accountants.

Before describing our present audit procedures in detail, I should like to refer to the types of audit work which we understand GAO conducts. I should add that, although the distinctions may seem to be clear from a conceptual standpoint, they tend to overlap in practice.

The audit of narrowest scope is termed by the GAO as an audit of financial operations and legal compliance. This is an audit of financial transactions, accounts and reports and of compliance with applicable laws and regulations.

A second category of audit relates to efficiency of operation. Policies, procedures, and transactions are examined to evaluate how well the agency carries out its programs and activities and how well it uses its financial, property, and personnel resources.

The third category of audit deals broadly with program results-- the extent to which desired results or benefits are being achieved and whether the objectives established by Congress are being met.

For its part, the Federal Reserve System has developed formal audit and examination procedures which are extremely thorough. The accounts of the Board of Governors are audited each year by a competent outside accounting firm of certified public accountants. Each accounting firm performs audits for five successive years, and is then replaced by another top-flight firm. Last year, the audit was conducted by Touche Ross & Co.; the preceding year, it was conducted by Lybrand, Ross Bros. & Montgomery, which ended a five-year cycle. Their audit report is reproduced in the Board's annual report, and copies of the report are furnished to this Committee and to the Senate Committee on Banking, Housing and Urban Affairs.

Each Federal Reserve Bank and branch is examined at least once each year by the Board's staff of field examiners. The examination includes a comprehensive review of each Bank's expenditures to determine if they are properly controlled and of a nature appropriate for a Reserve Bank. The outside accounting firm retained to audit the Board is engaged to accompany the Board's examiners on their examination of one of the Reserve Banks each year. This provides an external evaluation of the adequacy and effectiveness of the examination procedures.

In addition to the annual examination by the Board's examiners, the operations of each Reserve Bank are audited by the Bank's internal auditing staff on a year-round basis under the direction of a resident general auditor. He is responsible to the Bank's board of directors, through its chairman and its audit committee, and his selection is approved by the Board of Governors. He is thus independent of the Bank's operating management. Each year, the Board's examiners review thoroughly the resident audit programs at all the Reserve Banks to see that the coverage is adequate and the procedures effective.

Thus the auditing controls set up by the Federal Reserve begin with on-site auditors, independent of management, who review daily operations, security procedures, and conformance with System standards. Their constant presence provides continuous auditing and timely action.

The follow-up of the on-site activity is made by the Board's examiners in their examinations of the Reserve Banks. These are backed up by an "over-the-shoulder" inspection by the outside auditors of the work of the Board's examiners in examining a typical Reserve Bank. This is to bring current expertise over a broad range of accounting problems and auditing developments to that of the Board's examiners.

The system taken all together is thoroughly adequate and may even seem redundant. If one were to review audit findings and recommendations over the years, I doubt if he could come to any other conclusion. Over the years, most of the potential problems have been dealt with by resident auditors, and at no time in history has the internal auditing program of the Reserve Banks been stronger than it is today.

But thoroughness is necessary because the Federal Reserve Banks deal in the most fungible of all commodities--money--and in astronomical quantities. The Reserve Banks handle an annual flow of coin and currency of 27.8 billion pieces having a value of \$53.2 billion. The checks passing through the System each year on their way to becoming someone else's money total 9.8 billion items and \$3.7 trillion. The wire transfers are limited in number--only 11 million were handled last year, but they moved \$17 trillion. To perform these functions with a minimum loss or defalcation requires a comprehensive control and audit system. No system is perfect, but ours has worked well, as the record shows.

In recent years, the term "audit" has been broadened, as the GAO concepts indicate, to include a variety of objectives and techniques. I think it is clear from the description of Federal Reserve audit activities that I have given thus far that I have focused on what is generally called an audit of financial transactions. Such an audit of the Federal Reserve Banks covers:

- (a) the system of record-keeping and accounting control over money, checks, and securities coming into and going out of the Reserve Banks, as well as their expenses, earnings, assets, and liabilities;
- (b) the compliance with basic standards--in this case Federal law, and regulations and directives of the Board of Governors; and

(c) the availability of periodic reports summarizing the financial data in a manner which reveals the volume of work, relevant costs, and the net earnings (or losses) from operations.

I have spoken in detail about items (a) and (b) but have given little attention to (c). The reason is that our release of data about Federal Reserve operations on a daily, weekly, monthly, quarterly, annual, and ad hoc basis is enormous. (For your information, a copy of the Board's publications list is attached.)

Frequently, as you know, members of the Board testify fully at Congressional hearings on the policies and activities of the Federal Reserve System. The Board reports promptly and fully to special Congressional inquiries--particularly inquiries by Congressional committees involving the System's operations, policies, and expenditures.

Over the years, however, the System's audits have evolved considerably beyond the basic audit of financial transactions which I have described. The System now has in place the capacity to conduct reviews of management and operational efficiency. In some Banks, the independent auditor performs this function, in other cases it is handled by a separate division under the Reserve Bank President. In either event, Reserve Bank operations are exposed to a continuous review and evaluation by an extra-departmental unit.

Again paralleling the external arrangements for audits of financial transactions, the Board has a Division of Federal Reserve



Bank Operations which reviews the management and operational efficiency of the various facets of Reserve Bank operations. Many of these audits are a vehicle for sharing valuable experience among Federal Reserve Banks on such matters as check or money handling equipment and procedures. System committees of technicians provide still another arrangement for reaching the results sought by an audit of operations. These committees have provided much of the leadership and know-how for developing many innovations in various operations pertaining to securities handling (book entry), currency sorting, and check and wire transfers.

Finally, some of the Reserve Banks have used the services of private consulting firms to review the adequacy and efficiency of their operations. Such external reviews have been productive in evaluating the kinds of operations to which the consultant brings a special expertise. However, we have not found them to be very helpful when addressed to operations that are essentially unique to the Federal Reserve.

Stating our position at the cost-benefit level, the results from internal audits of operations have been much more productive than external audits. This seems to be due to the fact that a large sector of Federal Reserve Bank operations has a limited counterpart in public or private institutions either in character or scale. As a result, "outside" experts do not get much beyond the learning stage in their audits of these operations.

If the audit proposed in section 1 were to be confined to an audit of financial operations and legal compliance, some--but not all--of the Board's traditional objections would be removed. However, the Board is convinced that its present audit arrangements are more than adequate. A GAO audit limited to financial transactions and legal compliance would be a duplication of the audit now performed by an outside public accounting firm for the Board and by the Board itself for the Reserve Banks.

In a sense, Congress has designated the Board of Governors as its "GAO" for purposes of reviewing the operations of the Reserve Banks. The Board reports directly to Congress, and always stands ready to provide any information Congress seeks about expenditures by the System. If still another arm of Congress were directed to audit the Reserve Banks, this would, at a minimum, diffuse audit responsibility, and have a low benefit yield in relationship to the cost.

In any event, there are some critical informational constraints that should be imposed. They include exemption of examination reports of member banks, certain transactions conducted with and on behalf of foreign central banks, and sensitive information about open market and discount operations. (Much of the information in the latter two categories becomes available with a lag.) A high degree of confidentiality in these areas is essential for the conduct of Federal Reserve functions; granting GAO access to these records could pose problems in assuring this confidentiality.

If the audit were to go beyond a basic financial audit, and GAO typically does in the course of its ordinary audit activities, the injection of management and policy critiques by GAO would be inconsistent with the long-established Congressional policy that has insulated the Federal Reserve from such pressure. In the sensitive area of monetary policy, Congress has vested decision-making responsibility exclusively in the Federal Reserve, and has established safeguards to ensure that the System will exercise professional--and entirely independent--judgment. We believe this arrangement should continue so long as it serves the long-run interest of the public.

Also, as in the case of the audit of financial transactions, the broader GAO audits would be duplicative of the kind of audit functions which I have just described. Reviews of management and operational efficiency are now an integral part of the System's audit activities, both at the Reserve Banks and at the Board.

There is moreover the clear possibility, even probability, that an audit by GAO would in time generate pressures for the Federal Reserve System to dilute or compromise its best monetary or credit judgment to short-run rather than long-run interests. The structure created by the framers of the Federal Reserve Act over sixty years ago, however unique and unconventional, has turned out to be remarkably adaptable to the U. S. economy and remarkably responsive to its long-run interests. This structure combines the advantages of regional units--the twelve Federal Reserve Banks--with the central oversight and coordination of the Board.

Furthermore, it is obvious that the opponents of a monetary authority with the independence the Congress has long given the Federal Reserve would view this action as the opening wedge in a series of legislative measures by which they would hope to make monetary and credit policy responsive to short-run political and economic pressures. They would ask Congress to take further steps to place the Board either directly under an executive branch agency or perhaps under day-to-day Congressional control, however that might be accomplished. But Congress has, in our view, wisely avoided this possible line of development by continuing to place responsibility for internal management on the Board itself.

The unique character of the System, as conceived by the Congress, lies in the engagement of both the public and private sector, in all its regional variety, in the effort to serve the diverse economic interest of production, trade, agriculture, finance, and consumption. The Federal Reserve uses its regional links with the various sectors of the economy as channels for activation and response to monetary and credit measures. The arrangement has evolved into a sensing device of considerable value.

The System's blending of public and private elements, and its balance between central oversight and regional initiative, could be endangered if audits were to be conducted by GAO. This is not said in a spirit of criticism of the staff of GAO, but rather as a reflection

of our concern for the institutional diversity of the Federal Reserve. Where differences were encountered between the way the Reserve Banks function and prevailing Federal Government practice, the government auditors might well support the latter, whether or not the end result would prove superior. For our part, it would be difficult for the System to resist over the years a constant pressure to conform. A gradual process of erosion could begin which might well spell the end of the Reserve Banks as we know them today. We have serious doubts, moreover, whether the final outcome of such a process would yield public benefits that could match those flowing from the present structure.

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With regard to section 2, we support the amendment to section 14(b) of the Federal Reserve Act extending the authority of the Federal Reserve Banks to purchase United States obligations directly from the Treasury. Timely use of this authority--for example, during periods immediately preceding tax payment dates--can avoid the creation of unnecessary financial strains that might occur if the Treasury were required to draw heavily on its accounts at such times. There is no doubt the existence of the authority permits more economical cash management, and it also assures the immediate availability of funds in the event of a national emergency.

Section 3 of H. R. 10265 would authorize the expenditure by the Federal Reserve of an additional \$60 million for the construction and renovation of Reserve Bank branch buildings. This is the dollar figure contained in a bill which the Senate passed in February 1972. In February of this year, Chairman Burns wrote to the distinguished Chairman of this Committee outlining a program of branch building expenditures totaling \$71.45 million as the Board's best estimate of its most pressing needs through 1977. This would include funds for construction of new branch buildings in Baltimore, Charlotte, Omaha, and Los Angeles.

Construction of these buildings is urgently needed. As our population grows and moves, it is necessary to increase the quantity of our services. While technological improvements in the method of handling many Federal Reserve operations have helped to stem the need for additional space, increases in the volume of operations have more than offset the savings. In the decade 1963-72, checks collected by the Federal Reserve increased 117 per cent, coin operations increased 93 per cent, and currency operations 56 per cent. Construction of the branch buildings we are planning will help the System to continue to cope with the needs of the public in our expanding economy. As of today, due to cost increases, the construction program we outlined to Chairman Patman in February will cost \$76.2 million. We recommend that the dollar limitation in section 10 be increased by that amount.

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Aggregate Reserves and Member Bank Deposits (H.3)	Tuesday	Week ended previous Wednesday
Applications and Reports Received, or Acted on, by the Board (H.2)	Friday	Week ended previous Saturday
Assets and Liabilities of All Commercial Banks in the United States (H.8)	Wednesday	Wednesday, 2 weeks earlier
Capital Market Developments (H.16)	Monday	Week ended previous Friday
Changes in State Member Banks (K.3)	Tuesday	Week ended previous Saturday
Commercial and Industrial Loans Outstanding by Industry (H.12) <sup>2</sup>	Wednesday	Wednesday, 1 week earlier
Condition Report of Large Commercial Banks in New York and Chicago (H.4.3)	Thursday	Previous Wednesday
Condition Report of Large Commercial Banks and Domestic Subsidiaries (H.4.2) <sup>3</sup>	Wednesday	Wednesday, 1 week earlier
Deposits, Reserves, and Borrowings of Member Banks (H.7)	Wednesday	Week ended 3 Wednesdays earlier
Factors Affecting Bank Reserves and Condition Statement of Federal Reserve Banks (H.4.1)	Thursday	Week ended previous Wednesday
Money Stock Measures (H.6)	Thursday	Week ended Wednesday of previous week
Reserve Positions of Major Reserve City Banks (H.5)	Friday	Week ended Wednesday of previous week

<b>Weekly releases (cont.)</b>	<b>Approximate release day</b>	<b>Date or period to which data refer</b>
Selected Interest and Exchange Rates for Major Countries and the United States (H.13)	Thursday	Week ended previous Saturday
Weekly Foreign Exchange Rates (H.10)	Monday	Week ended previous Friday
Weekly Summary of Banking and Credit Measures (H.9)	Thursday	Week ended previous Wednesday; and week ended Wednesday of previous week
Weekly U.S. Government Security Yields and Prices (H.15)	Monday	Week ended previous Saturday
<b>Semimonthly and bimonthly releases</b>		
Finance Rates and Other Terms on Selected Categories of Consumer Instalment Credit Extended by Finance Companies (J.3)	20th of month	2nd month previous
Research Library—Recent Acquisitions (J.2)	1st and 16th of month	Period since last release
<b>Monthly releases</b>		
Assets and Liabilities of All Member Banks by Districts (G.7.1)	14th of month	Last Wednesday of previous month
Automobile Loans by Major Finance Companies (G.25)	7th working day of month	2nd month previous
Automobile Instalment Credit Developments (G.26)	6th working day of month	2nd month previous
Bank Debits, Deposits, and Deposit Turnover (G.6)	25th of month	Previous month
Commercial and Industrial Term Loans Outstanding by Industry (H.12b) Available only as attachment to weekly H.12 release	2nd Wednesday of month	Last Wednesday of previous month
Consumer Credit (G.19)	3rd working day of month	2nd month previous
Consumer Instalment Credit at Commercial Banks (G.18)	4th working day of month	2nd month previous
Finance Companies (G.20)	5th working day of month	2nd month previous
Finance Rate and Other Terms on New and Used Car Instalment Credit Contracts Purchased from Dealers by Major Auto Finance Companies (G.11)	30th of month	Previous month
Index Numbers of Wholesale Prices (G.8)	20th of month	Previous month
Industrial Production (G.12.2)	15th of month	Previous month
Industrial Production and Related Data (G.12.3) (Similar data also available annually. see p. A-116)	15th of month	Previous month
Interdistrict Settlement Fund (G.15)	15th of month	Previous month
Interest Rates Charged on Selected Types of Bank Loans (G.10)	15th of month	2nd month previous

## FEDERAL RESERVE BOARD PUBLICATIONS

Monthly releases (cont.)	Approximate release day	Date or period to which data refer
Maturity Distribution of Euro-Dollar Deposits in Foreign Branches of U.S. Banks (G.17)	1st of month	Last day of 3rd month previous
Maturity Distribution of Outstanding Negotiable Time Certificates of Deposits (G.9)	24th of month	Last Wednesday of previous month
Monthly Foreign Exchange Rates (G.5)	1st of month	Previous month
Open Market Money Rates and Bond Prices (G.13)	6th of month	Previous month
State Member Banks of Federal Reserve System and Non-member Banks that Maintain Clearing Accounts with Federal Reserve Banks (G.4)	1st week of month	Previous month
(Also annual)	1st week of February	End of previous year
Summary of Equity Security Transactions (G.16)	Last week of month	Release date
U.S. Government Security Yields and Prices (G.14)	4th of month	Previous month

## Quarterly releases

Bank Rates on Short Term Business Loans (E.2)	18th of March, June, September, December	1st 15 days of February, May, August, November
Capacity Utilization in Manufacturing (E.5)	21st of January, April, July, October	Previous quarter
Flow of Funds: Seasonally adjusted and unadjusted (Z.1) Seasonally adjusted <b>only</b> (Z.1a)	15th of February, May, August, and November	Previous quarter
Volume and Composition of Individuals' Saving (Flow of funds series) (E.8)		
Sales, Profits, and Dividends of Large Corporations (E.6) <sup>4</sup>	10th of April, June, September, December	2nd quarter previous

## Semiannual releases

Assets and Liabilities of All Commercial Banks, by Class of Bank (E.3.4)	May and November	End of previous December and June
List of OTC Margin Stocks (E.7)	June 30, December 31	Release date
Assets, Liabilities, and Capital Accounts of Commercial and Mutual Savings Banks—Reports of Call (Joint Release of Federal Deposit Insurance Corp., Board of Governors of Federal Reserve System, and Office of Comptroller of the Currency. <i>Published and distributed by FDIC.</i> )	May and November	End of previous December and June

Annual releases	Approximate release day	Date or period to which data refer
Bank Debits to Demand Deposit Accounts Except Interbank and U.S. Government Accounts (C.5)	March 25	Previous year
End of Month Demand Deposits Except Interbank and U.S. Government Accounts (C.5a)	March 25	Previous year
Federal Reserve Par List (G.3)	Early November	Previous September 30
(Also monthly supplements)	5th of month	Period since last release
Industrial Production and Related Data (Available upon request, after being announced)	November	Previous year
Member Bank Income (C.4)	End of May	Previous year

<sup>1</sup>Release dates are those anticipated or usually met. However, it should be noted that for some releases there is normally a certain variability because of reporting or processing procedures. Moreover, for all series unusual circumstances may, from time to time, result in a release date being later than anticipated.

<sup>2</sup>Contains monthly H.12b release on second Wednesday of month.

<sup>3</sup>Contains revised H.4.3 data.

<sup>4</sup>Publication temporarily suspended.

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