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Statement of Wm. McC. Martin, Jr.

Chairman, Board of Governors of the Federal Reserve System

on H. R. 7602

before the

House Committee on Government Operations

June 2, 1954

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I am here in response to a request from Chairman Hoffman to appear and testify on the bill H. R. 7602, which would direct the Comptroller General to make an audit for the year ending December 31, 1953, of the Board of Governors of the Federal Reserve System, the Federal Open Market Committee, and the Federal Reserve Banks and their branches.

The Board of Governors recognizes the importance of budgetary and accounting procedures that will make for effective and efficient operations throughout the Federal Reserve System and is entirely in sympathy with the objectives sought in various proposals on the subject that have been advanced in the Congress. Fully effective procedures are already provided, however, and to superimpose a further budgetary and auditing review upon the existing procedures is neither necessary nor advisable.

The functions and responsibilities of the Board of Governors and the Federal Reserve Banks are such that Congress has provided that they be carried out with independent discretion and judgment. Accordingly, the expenses of the Board and of the Federal Reserve Banks are not subject to the budgetary and auditing control of any other agency of Government. The Board of Governors is the governmental supervisory agency of the reserve banking system and as such has responsibility for general supervision over expenditures at the Reserve Banks (which include the great bulk of System expenditures). It also has direct responsibility for expenditures at the Board.

For many years the Board had its own accounts audited by representatives of the auditing departments of the seven nearest Federal Reserve Banks on a rotating basis. However, in order to avoid any question as to the impartiality of these audits, in 1952 the Board engaged the firm of

Arthur Andersen & Co. to audit its accounts. The certificate of the audit for 1952 was included in the Board's Annual Report for that year. The firm has completed an audit of the Board's records for the year 1953 and a copy of its report has been sent to the Congressional Banking and Currency Committees.

Manifestly, Federal Reserve operations should be conducted with maximum efficiency and economy. To that end Congress placed upon the Board of Governors, which is a part of the Government, direct responsibility for general supervision and periodic examination of the Federal Reserve Banks. The Federal Reserve Act also provides that each Federal Reserve Bank should have a board of directors of nine men chosen from their respective districts. They are outstanding men in their communities, prominently identified with industry, commerce, agriculture, banking, and professional life, who bring to the Reserve Banks their personal experience in applying high standards of efficiency in their fields of private enterprise. It has thus been aptly said that the Federal Reserve combines advantages of Governmental control with advantages of private business management.

The Board believes that the Congress has provided a sound, prudent, and adequate means of achieving efficiency and economy in Federal Reserve operations by combining in one agency, which of necessity is thoroughly informed concerning Federal Reserve Bank operations, not only the authority to examine and audit, but also the power to put into effect through its supervisory authority any improvements the need for which is thus disclosed. Legislation to superimpose a further audit of these operations by another Government agency would make for duplication and needless expense. Moreover, the audit might constitute an entering wedge in

encroaching upon that independence of judgment which Congress has sought to safeguard. Such independence of judgment is indispensable in the determination and execution of impartial credit and monetary policy. If through some measure of control over the finances of the reserve banking system, another agency of Government could restrict operations which the System deemed necessary in performing its statutory functions, the resulting substitution of judgment could only result in a growing loss of effectiveness of the Reserve System.

In meeting its statutory responsibility of exercising general supervision over the Reserve Banks, the Board constantly strives through budgetary measures, comparative cost studies, and similar methods to increase economy and efficiency of operations. In addition, its staff of examiners conducts a thorough and effective annual examination of each Federal Reserve Bank and branch.

In order to be assured that its examination procedures meet the highest standards of commercial auditing procedures and techniques, the Board has adopted the policy of engaging a nationally recognized public accounting firm to accompany the examiners on one Federal Reserve Bank examination each year for the purpose of reviewing and observing the procedures in actual use.

The Federal Open Market Committee by statute is exclusively a policy making body and, therefore, does not handle any funds. However, the annual examination of the Federal Reserve Bank of New York, which is the bank designated to carry out System open market transactions for the twelve Federal Reserve Banks, as directed by the Federal Open Market Committee, includes a comprehensive examination of the accounts relating to these transactions.

The Board believes enactment of the bill, H. R. 7602, would conflict with the fundamental purposes which Congress has sought to achieve in the Federal Reserve Act and, therefore, would be contrary to the public interest.