FDIC
Federal Deposit Insurance Corporation
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Office of Inspector General

Management and Performance Challenges Identified by the FDIC OIG

Introduction

The Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the Congress to maintain stability and confidence in the nation's baking system by insuring deposits, examining and supervising financial institutions, and managing receiverships. According the Corporation's Letter to Stakeholders, issued for the 3rd Quarter 2003, as of September 20, 2003, the FDIC insured $3.416 trillion in deposits for 9,282 institutions, of which the FDIC supervised 5,343 institutions. The FDIC had $825 million in assets in liquidation and 34 receiverships. The Corporation held insurance funds of $44.9 billion to ensure depositors are safeguarded.

In the spirit of the Reports Consolidation Act of 2000, we are providing the Office of Inspector General's (OIG) assessment of the most significant management and performance challenges facing the Corporation. The Act calls for these challenges to be included in the agency's annual consolidated performance and accountability report. For 2002, the FDIC included its performance and accountability report as part of the *Federal Deposit Insurance Corporation Annual Report 2002*. The 10 challenges we have identified are listed in priority order and fall under two categories. The first category, which includes challenges 1 through 4, relates to rather broad corporate and industry issues, and the second category, challenges 5 through 10, relates to more specific operational issues at the FDIC.

On October 17, 2003, we shared a draft listing of these management and performance challenges with the corporate divisions and offices. Detailed comments were provided to our office through the Office of Internal Control Management on November 7, 2003. We appreciate the cooperation and coordination of the divisions and offices in formulating our assessment. Their comments on the challenges attest to the fact that the Corporation has a number of actions underway to address many of the areas discussed, and we encourage continued attention to each of the challenges. For its part, the OIG will continue to add value by conducting audits, evaluations, investigations, and other reviews that address the challenges outlined in the attached document. We look forward to continuing to work with all FDIC Divisions and Offices to successfully address them.

The following challenges are presented in this document:

1. Adequacy of Corporate Governance in Insured Depository Institutions
2. Protection of Consumer Interests
3. Management and Analysis of Risks to the Insurance Funds
4. Effectiveness of Resolution and Receivership Activities
5. Management of Human Capital
6. Management and Security of Information Technology Resources
7. Security of Critical Infrastructure

8. Management of Major Projects
9. Assessment of Corporate Performance
10. Cost Containment and Procurement Integrity

1. <u>Adequacy of Corporate Governance in Insured Depository Institutions</u>

Corporate governance is generally defined as the fulfillment of the broad stewardship responsibilities entrusted to the Board of Directors, Officers, and external and internal auditors of a corporation. A number of well-publicized announcements of business failures, including financial institution failures, have raised questions about the credibility of accounting practices and oversight in the United States. These recent events have increased public concern regarding the adequacy of corporate governance and, in part, prompted passage of the Sarbanes-Oxley Act of 2002. The public's confidence in the nation's financial system can be shaken by deficiencies in the adequacy of corporate governance in insured depository institutions. For example, the failure of senior management, boards of directors, and auditors to effectively conduct their duties has contributed to some recent financial institution failures. In certain cases, board members and senior management engaged in high-risk activities without proper risk management processes, did not maintain adequate loan policies and procedures, and circumvented or disregarded various laws and banking regulations. In other cases, independent public accounting firms rendered clean opinions on the institutions' financial statements when, in fact, the statements were materially misstated. To the extent that financial reporting is not reliable, the regulatory processes and FDIC mission achievement (that is, ensuring the safety and soundness of the nation's financial system) can be adversely affected. For example, essential research and analysis used to achieve the supervision and insurance missions of the Corporation can be complicated and potentially compromised by poor quality financial reports and audits. The insurance funds could be affected by financial institution and other business failures involving financial reporting problems. In the worst case, illegal and otherwise improper activity by management of financial institutions or their boards of directors can be concealed, resulting in potential significant losses to the FDIC insurance funds.

The FDIC has initiated various measures designed to mitigate the risk posed by these concerns, such as reviewing the bank's board activities and ethics policies and practices and reviewing auditor independence requirements. In addition, the FDIC reviews the financial disclosure and reporting obligations of publicly traded state non-member institutions. The FDIC also reviews their compliance with Securities and Exchange Commission regulations and the Federal Financial Institutions Examination Council (FFIEC)-approved and recommended policies to help ensure accurate and reliable financial reporting through an effective external auditing program and on-site FDIC examination. Other corporate governance initiatives include the FDIC's issuing

Financial Institution Letters, allowing bank directors to participate in regular meetings between examiners and bank officers, maintaining a "Directors' Corner" on the FDIC Web site, and the expansion of the Corporation's "Directors' College" program. Also, the Chairman has established leadership challenges for FDIC managers that strive to promote external confidence in the FDIC and the confidence of FDIC staff in addressing the strategic goals of the Corporation. While the FDIC has taken significant strides, the risk remains that corporate governance issues are a key concern.

Also, pursuant to the Economic Growth and Regulatory Reduction Act of 1996, the FDIC, along with the other members of the FFIEC, is engaged in reviewing regulations in order to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions. The OIG supports prudent opportunities to reduce regulatory burdens on insured depository institutions along with consideration to the impact on the FDIC's ability to adequately supervise the institutions.

2. Protection of Consumer Interests

The FDIC's mission is to maintain public confidence in the Nation's financial system. The availability of deposit insurance to protect consumer interests is a very visible way in which the FDIC accomplishes this mission. However, the FDIC also serves as an advocate for consumers through its oversight of a variety of statutory and regulatory requirements aimed at protecting consumers from unfair and unscrupulous banking practices. The FDIC is legislatively mandated to enforce various statutes and regulations regarding consumer protection and civil rights with respect to state-chartered, non-member banks and to encourage community investment initiatives by these institutions. Some of the more prominent laws and regulations related to this area include the Truth in Lending Act, Fair Credit Reporting Act, Real Estate Settlement Procedures Act, Fair Housing Act, Home Mortgage Disclosure Act, Equal Credit Opportunity Act, Community Reinvestment Act of 1977, and Gramm-Leach-Bliley Act (GLBA).

The Corporation accomplishes its mission related to fair lending and other consumer protection laws and regulations by conducting compliance examinations, taking enforcement actions to address compliance violations, encouraging public involvement in the community reinvestment process, assisting financial institutions with fair lending and consumer compliance through education and guidance, and providing assistance to various parties within and outside of the FDIC.

The FDIC's examination and evaluation programs must assess how well the institutions under its supervision manage compliance with consumer protection and fair lending laws and regulations and meet the credit needs of their communities, including low and moderate income neighborhoods. The FDIC must also work to issue regulations that implement federal consumer protection statutes both on its own initiative and together with the other federal financial institution regulatory agencies. One important focus will be the GLBA, because the Corporation must ensure it has a quality program to examine institution compliance with privacy and other provisions of the Act.

The Corporation's community affairs program provides technical assistance to help banks meet their responsibilities under the Community Reinvestment Act. One current emphasis is on financial literacy, aimed specifically at low- and moderate-income people who may not have had banking relationships. The Corporation's "Money Smart" initiative is a key outreach effort. The FDIC must also continue efforts to maintain a Consumer Affairs program by investigating consumer complaints about FDIC-supervised institutions, answering consumer inquiries regarding consumer protection laws and banking practices, and providing data to assist the examination function.

The Corporation's deposit insurance program promotes public understanding of the federal deposit insurance system and seeks to ensure that depositors and bankers have ready access to information about the rules for FDIC insurance coverage. Informing bankers and depositors about the rules for deposit insurance coverage fosters public confidence in the banking system by helping depositors to ensure that their funds are fully protected.

Protection of Consumer Interests continues to be a challenge. A number of new consumer protection regulations have been introduced over the past several years. The emergence and continued expansion of electronic banking presents a challenge for ensuring consumers are protected. The number of reported instances of identity theft has ballooned in recent years. The Corporation will need to remain vigilant in conducting comprehensive, risk-based compliance examinations, analyzing and responding appropriately to consumer complaints, and educating individuals on money management topics, including identity protection.

3. Management and Analysis of Risks to the Insurance Funds

A primary goal of the FDIC under its insurance program is to ensure that its deposit insurance funds do not require augmentation by the U.S. Treasury. Achieving this goal is a considerable challenge given that the FDIC supervises only a portion of the insured depository institutions. The identification of risks to non-FDIC supervised institutions requires effective communication and coordination with the other federal banking agencies. The FDIC engages in an ongoing process of proactively identifying risks to the deposit insurance funds and adjusting the risk-based deposit insurance premiums charged to the institutions.

Recent trends and events continue to pose risks to the funds. From January 1, 2002 to November 25, 2003, 14 insured financial institutions failed, and the potential exists for additional failures. While some failures may be attributable primarily or in part to economic factors, bank mismanagement and fraud have also been factors in the most recent failures. The environment in which financial institutions operate is evolving rapidly, particularly with the acceleration of interstate banking, new banking products and complex asset structures, and electronic banking. The industry's growing reliance on technologies, particularly the Internet, has changed the risk profile of banking. Continuing threats to the U.S. financial infrastructure have made business continuity planning an essential ingredient to sound risk management programs. The consolidations that may occur among banks, securities firms, insurance companies, and other financial services providers resulting from the Gramm-Leach-Bliley Act pose additional risks to the FDIC's insurance funds. Also, institutions face challenges in managing interest rate risks in an environment of historically low interest rates. The Corporation's supervisory approach, including risk-focused examinations, must operate to identify and mitigate these risks and their real or potential impact on financial institutions to preclude adverse consequences to the insurance funds.

Another risk to the insurance funds results from bank mergers that have created "megabanks," or "large banks," which are generally defined as institutions with assets of over $25 billion, presenting a concentration risk to the funds. For many of these institutions, the FDIC is the insurer but is not the primary federal regulator. Megabanks offering new or expanded services also present challenges to the FDIC. For example, the failure of a megabank, along with the potential closing of closely affiliated smaller institutions, could result in losses to the deposit insurance funds that require significant increases in premium assessments from an institution. With regard to the risks associated with "megabanks," or "large banks" for which the FDIC is the insurer but is not the primary federal regulator, in 2002, the FDIC initiated the Senior Examiner Program for the eight largest banks in the U.S. These senior examiners are dedicated to that institution and participate in targeted reviews or attend management meetings. Also, case managers closely monitor such institutions through the Large Insured Depository Institutions Program's quarterly analysis and executive summaries. Additionally, case managers consistently remain in communication with their counterparts at the other regulatory agencies, frequently attending pre-examination meetings, post-examination meetings, and exit board meetings.

Further, because of bank mergers and acquisitions, many institutions hold both Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF) insured deposits, obscuring the difference between the funds. There is ongoing consideration of merging the two insurance funds with the perceived outcome being that the merged fund would not only be stronger and better diversified but would also eliminate the concern about a deposit insurance premium disparity between the BIF and the SAIF. Assessments in the merged fund would be based on the risk that institutions pose to that fund. The prospect of different premium rates for identical deposit insurance coverage would be eliminated.

Also, insured institutions would no longer have to track their BIF and SAIF deposits separately, resulting in cost savings for the industry. The Corporation has worked hard to bring about deposit insurance reform, and the OIG supports the FDIC's continued work with the banking community and the Congress in the interest of eventual passage of reform legislation.

Adoption of the proposed Basel Committee II Capital Accord poses a potential additional threat to the insurance funds due to the prospect of lower minimum capital requirements for large institutions. The initial Basel Capital Accord only took credit risks into account; Basel II will require that banks evaluate and measure other forms of risk, including operational risk. Banks will have to make capital provisions to effectively act as a contingency fund, to cover the direct and indirect losses that emergent operational risks could cause. The failure of at-risk institutions to fully adhere to this proposed contingency funding mechanism in place of higher minimum capital requirements constitutes a threat of increased insurance losses to the funds.

Another risk to the insurance funds relates to the designated reserve ratio. As of March 31, 2002, the BIF reserve ratio was at 1.23 percent, the first time since 1995 that the ratio had fallen below the statutorily mandated designated reserve ratio of 1.25 percent for the deposit insurance funds. (If the BIF ratio is below 1.25 percent, in accordance with the Federal Deposit Insurance Act, the FDIC Board of Directors must charge premiums to banks that are sufficient to restore the ratio to the designated reserve ratio within 1 year. The Corporation must maintain or exceed the designated reserve ratio, as required by statute.) By June 30, 2002, the BIF reserve ratio was at 1.25 percent, precisely at the minimum mandated level. As of June 30, 2003, the BIF ratio was at 1.29 percent.

The process for setting deposit insurance premiums, which is closely related to the above discussion of the designated reserve ratio, represents yet another significant risk to the insurance funds. Insurance premiums are generally assessed based on the funding requirements of the insurance funds independent of the financial risk to the funds for institutions that pose safety and soundness concerns. This approach has the impact of assessing premiums during economic downturns when banks are failing and are likely not in the best position to afford the premiums. Also, numerous institutions have benefited from being able to sharply increase insured deposits without contributions to the insurance funds commensurate with this increased risk. This situation can occur because the designated reserve ratio is not breached, thereby triggering across-the-board premiums. Current deposit insurance reform proposals include provisions for risk-based premiums to be assessed on a more frequently scheduled basis than would occur using the existing approach. Risk-based premiums can provide the ability to better match premiums charged to institutions with related risk to the insurance funds.

Internally, the Corporation is currently operating under an internal control policy that predates many developments toward proactive risk management. Since the Corporation issued its internal control policy in February 1998, the U.S. General Accounting Office (GAO) has issued *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, November 1999) which discusses five components of internal control and provides an overall framework for identifying and addressing major performance challenges and areas of greatest risk for fraud, waste, abuse, and mismanagement. Also, many organizations in the insurance industry and other organizations have begun using an Enterprise Risk Management (ERM) approach to managing not only financial risks, but all business and compliance risks. ERM is a process that incorporates the five components of internal control and provides: (1) the mechanisms to help staff understand risk in the context of the entity's objectives and (2) assurance that the organization will be able to execute its business strategy and achieve its objectives. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) recently issued a draft document which explains essential concepts and the interrelationship between ERM and internal control.

4. Effectiveness of Resolution and Receivership Activities

One of the FDIC's corporate responsibilities is planning and efficiently handling the franchise marketing of failing FDIC-insured institutions and providing prompt, responsive, and efficient resolution of failed financial institutions. These activities maintain confidence and stability in our financial system.

The FDIC has outlined primary goals for three business lines (listed below) that are relevant to the three major phases of its work: Pre-Closing, Closing, and Post-Closing of failing or failed institutions. Each is accompanied by significant challenges:

a. Deposit Insurance. The FDIC must provide customers of failed financial institutions with timely access to their insured funds and financial services. A significant challenge in this area is to ensure that FDIC deposit insurance claims and payment processes are prepared to handle large institution failures.

b. Resolutions. As the FDIC seeks to resolve failed institutions in the least costly manner, its challenges include improving the efficiency of contingency planning for institution failures and improving internal FDIC communication and coordination as well as communication with the other primary federal regulators. These improvements will help ensure timely access to records and optimal resolution strategies.

c. Receivership Management. The FDIC's goal is to manage receiverships to maximize net return toward an orderly and timely termination and provide customers of failed institutions and the public with timely and responsive information. Related challenges include improving the efficiency of the receivership termination process, improving claims processing, continual assessment of recovery strategies, improving investigative activities, collection of restitution orders, and charging receiverships for services (such as service costing) performed under the Receivership Management Program.

5. Management of Human Capital

Human capital issues pose significant elements of risk that interweave all the management and performance challenges facing the FDIC. The FDIC has been in a downsizing mode for the past 10 years as the workload from the banking and thrift crises of the late l980s and 1990s has been accomplished. A number of division mergers and reorganizations took place, and the Corporation concluded its 2002 buyout/retirement incentive programs. These incentive programs achieved a reduction of 699 staff and projected annual savings of $80 million in future operating costs. In total, over the past 10+ years, the workforce (combined from the FDIC and the Resolution Trust Corporation) has decreased from approximately 23,000 in 1992 to approximately 5,300 as of November 15, 2003.

The Corporation hopes to substantially complete required downsizing, identify an appropriate skills mix, and correct any existing skills imbalances. To do so, the Corporation continues to carry out other features of its comprehensive program such as solicitations of interest, reassignments, retraining, outplacement assistance, and possible reductions-in-force. The Corporation has also predicted that about 20 percent of FDIC employees will be eligible to retire within the next 5 years. As the Corporation adjusts to a smaller workforce, it must continue to ensure the readiness of its staff to carry out the corporate mission, including through succession planning and other human capital initiatives.

The Corporation must also work to fill key vacancies in a timely manner, engage in careful succession planning, and continue to conserve and replenish the institutional knowledge and expertise that has guided the organization over the past years. A need for additional outsourcing may arise, and hiring and retaining new talent will be important. Hiring and retention policies that are fair and inclusive must remain a significant component of the corporate diversity plan. Designing, implementing, and maintaining effective human capital strategies are critical priorities and must be the focus of centralized, sustained corporate attention.

As the FDIC moves past an era that has been characterized by continual downsizing, the demands placed on the Corporation by a rapidly changing external environment require a dynamic and strategic approach to managing the Corporation's human capital. The FDIC must remain flexible in managing changes in the Corporation's workload and business processes that may have an impact on the size and skill composition of its workforce, whether these changes are planned or unanticipated. It is incumbent on all executives and managers in the FDIC to continually assess the goals and objectives, workload, and staffing of their organizations and to take appropriate steps to ensure that they have a workforce with the right experience and skills to fulfill their mission. It is imperative that the Corporation's business planning and human resources processes incorporate effective means to manage such changes in the size and skill composition of our workforce, in order to promote efficiency and productivity and diminish the possibility of a future RIF.

The FDIC has undertaken significant efforts to address skill levels and maintain the preservation of institutional knowledge by creating the FDIC Corporate University. The Corporate University is comprised of the following five Schools: (1) Supervision and Consumer Protection, (2) Resolutions and Receiverships, (3) Insurance, (4) Leadership Development, and (5) Corporate Operations. Also the Corporate University contains a Center for Career and Educational Services which strives to prepare employees to more effectively manage their careers by offering developmental programs, career counseling, forums, workshops and seminars.

Also, the Division of Information Resources Management (DIRM) initiated a priority project called the Comprehensive Information Technology (IT) Program Review. One aspect of this effort is an assessment of human capital needs and a plan to identify and address any shortfalls in staff resources or skills mix for the IT security program. The human capital staffing plan and its inclusion in the System Security Management Tactical Plan are targeted for completion in January 2004. Until an assessment is performed, and a human capital plan developed and tracked, the FDIC is at risk of not having the appropriate staffing resources to manage the IT security program.

6. <u>Management and Security of Information Technology Resources</u>

Information technology (IT) continues to play an increasingly greater role in every aspect of the FDIC mission. As corporate employees carry out the FDIC's principal business lines of insuring deposits, examining and supervising financial institutions, and managing receiverships, the employees rely on information and corresponding technology as an essential resource. Information and analysis on banking, financial services, and the economy form the basis for the development of public policies and promote public understanding and confidence in the nation's financial system. IT is a critical resource that must be safeguarded.

Accomplishing IT goals efficiently and effectively requires sound IT planning and investment control processes. The Corporation's 2003 IT budget is approximately $175 million. The Corporation must constantly evaluate technological advances to ensure that its operations continue to be efficient and cost-effective and that it is properly positioned to carry out its mission. While doing so, the Corporation must continue to respond to the impact of laws and regulations on its operations. Management of IT resources and IT security have been the focus of several laws, such as the Paperwork Reduction Act, the Government Information Security Reform Act (GISRA), and most recently, the Federal Information Security Management Act (FISMA) of 2002. Similar to the requirements of GISRA, under FISMA, each agency is required to report on the adequacy and effectiveness of information security policies, procedures, and practices and compliance with information security requirements.

The Corporation has worked to implement many sound information system security controls but has not yet fully integrated these controls into an entity-wide program. Additionally, continued attention is needed in efforts to identify sensitive data, plan for and fund essential security measures, incorporate security requirements in FDIC contracts, enhance software configuration management, and measure the overall performance of the information security program. Frequently, security improvements at the FDIC were the result of a reaction to specific audit and review findings, rather than the result of a comprehensive program that provided continuous and proactive identification, correction, and prevention of security problems. Also, the FDIC has made significant progress in the formation of an enterprise-wide IT architecture that maps the current and "to-be" states of business processes and the supporting information systems and data architecture. However, a fully integrated enterprise architecture outlining the knowledge management concepts FDIC intends to employ to keep pace with innovation in the banking industry is not yet complete.

We concluded in our 2002 Security Act evaluation report that the FDIC made significant progress in improving its information security operations in recent years. However, new security requirements have "raised the bar" for measuring success of the FDIC's security program. Our evaluation report contains specific steps intended to further the Corporation's efforts to develop and implement information security controls that provide assurance of adequate security for its information resources. Thus, management and security of information technology resources continue to warrant management attention.

7. <u>Security of Critical Infrastructure</u>

The adequate security of our nation's critical infrastructures has been at the forefront of the federal government's agenda for many years. Specifically, the President's Commission on Critical Infrastructure Protection (established in July 1996) was tasked to formulate a comprehensive national strategy for protecting the nation's critical infrastructure from physical and "cyber" threats. Included among the limited number of systems whose incapacity or destruction were deemed to have a debilitating impact on the defense or economic security of the nation was the banking and finance system. With the increased consolidation and connectivity of the banking industry in the years since 1996, and with the new awareness of the nation's vulnerabilities to terrorist attacks since September 11, 2001, the security of the critical infrastructure in the banking industry is even more important.

On May 22, 1998, Presidential Decision Directive (PDD) 63 Title 5 was signed. The directive called for a national effort to ensure the security of the nation's critical infrastructures. PDD 63 defined the critical infrastructure as the "physical and cyber-based systems essential to the minimum operations of the economy and government." The President declared that securing our critical infrastructure is essential to our economic and national security and issued two Executive Orders (EO 13228, *The Office of Homeland Security and the Homeland Security Council*, and EO 23231, *Critical Infrastructure Protection in the Information Age*) to improve the federal government's critical infrastructure protection program in the context of PDD 63.

The intent of PDD 63 is to ensure that the federal government maintains the capability to deliver services essential to the nation's security and economy and to the health and safety of its citizens in the event of a cyber- or physical-based disruption. Much of the nation's critical infrastructure historically has been physically and logically separate systems that had little interdependence. However, as a result of technology, the infrastructure has increasingly become automated and interconnected. These same advances have created new vulnerabilities to equipment failures, human error, natural disasters, terrorism, and cyber-attacks.

To effectively protect critical infrastructure, the FDIC's challenge in this area is to implement measures to mitigate risks, plan for and manage emergencies through effective contingency and continuity planning, coordinate protective measures with other agencies, determine resource and organization requirements, and engage in education and awareness activities. The FDIC will need to continue to work with the Department of Homeland Security and the Finance and Banking Information Infrastructure Committee, created by Executive Order 23231 and chaired by the Department of the Treasury, on efforts to improve security of the critical infrastructure of the nation's financial system. To address this risk, the FDIC is sponsoring 24 outreach conferences for the Financial and Banking Information Infrastructure Committee and Financial Services Sector Coordinating Council through 2005, which will address protecting the financial sector.

8. <u>Management of Major Projects</u>

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Project management is the defining, planning, scheduling, and controlling of the tasks that must be completed to reach a goal and the allocation of the resources to perform those tasks. The FDIC has engaged in several multi-million dollar projects, such as the New Financial Environment, Central Data Repository, and Virginia Square Phase II Construction. Without effective project management, the FDIC runs the risk that corporate requirements and user needs may not be met in a timely, cost-effective manner.

In September 2002, the FDIC executed a multi-year contract to replace its core financial systems and applications with a commercial-off-the-shelf software package. The New Financial Environment (NFE) is a major corporate initiative to enhance the FDIC's ability to meet current and future financial management and information needs. At the time the Board case was approved, the FDIC estimated the total life-cycle cost of NFE, including FDIC staff time, to be approximately $62.5 million over 8 years. NFE offers the FDIC significant benefits and presents significant challenges. These challenges will test the Corporation's ability to (1) maintain unqualified opinions on the FDIC's annual financial statements through the system implementation and associated business process reengineering; (2) manage contractor resources, schedules, and costs; and (3) coordinate with planned and ongoing system development projects related to NFE. We reviewed the project control framework for the NFE and determined that, among other matters, the FDIC had not formally defined an integrated control framework for the project at the time of our review. Without an integrated framework, it would be challenging for the FDIC to ensure accountability and a corporate approach on the project. Also, we reviewed the controls for ensuring that the scope of the NFE project was effectively managed and any cost or schedule adjustments were properly evaluated and controlled. We determined that improvements were needed in scope management, project oversight, and time management. Should these conditions not be promptly corrected, the project is less likely to be deployed on schedule, which could increase contracting costs.

The Call Report Modernization project is a collaborative effort by the FDIC, FRB, and OCC to improve the processes and systems used to collect, validate, store, and distribute Call Report information. The project resulted in a Central Data Repository (CDR) approach to managing bank Call Report Information. The agencies developed a consensus vision for a new Call Report processing business model that incorporates open data standards, uses a common reporting language, and offers tools to enable banks to submit better reports. The goals of the proposed environment are to create: (1) a single CDR serving as the official source of all the information necessary for collecting, validating, and distributing bank Call Report information; (2) a process driven by uniform business rules leveraging existing standards; (3) a movement of regulators and reporters to a recognizable Internet standard; (4) a common, comprehensive set of FFIEC data quality assurance standards that will be defined and published; and (5) a requirement that only Call Reports that pass all math validation criteria and that provide text explanations for logical/qualitative validation criteria exceptions will be accepted.

The Call Modernization Steering Committee of the FFIEC Task Force on Reports recommended three actions necessary to implement a CDR contract:

a. Funding a contract to be awarded for an initial period of 7 years, with three 1-year option periods, in the amount not to exceed $44 million for the entire 10-year term;

b. Entering into a Memorandum of Understanding governing the development and operation of the facility, including business policy and oversight roles, subject to concurrence by the FRB and the OCC; and

c. Entering into an agreement for sharing costs of implementing and operating the facility, subject to concurrence by the FRB and the OCC. The recommended formula for cost sharing is 72 percent of the costs to the FDIC, 23 percent to the FRB, and 5 percent to the OCC.

At the Corporation's request, we are currently reviewing issues that could impact the cost and timeliness of the CDR project. This project presents significant risks and challenges due to the involvement of new technology and multiple agencies.

Additionally, in March 2002, the Board of Directors approved construction of a new nine-story building at the FDIC's Virginia Square campus in Northern Virginia. Known as Virginia Square Phase II, the building will house FDIC staffers (about 1,100) for the most part now working in leased space. The expansion will cost approximately $111 million. The building is expected to be finished in 2006. Completing construction activities and moving staff from leased to owned space within the planned time and cost budgets presents considerable challenges for FDIC management.

The Corporation must ensure that employees from all divisions and offices properly safeguard the Bank Insurance and Savings Association Insurance Funds. It is critically important that budgets for major projects be established and closely monitored to prevent significant cost overruns.

9. <u>Assessment of Corporate Performance</u>

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The Government Performance and Results Act (Results Act) of 1993 was enacted to improve the efficiency, effectiveness, and accountability of federal programs by establishing a system for setting goals, measuring performance, and reporting on accomplishments. The Results Act requires most federal agencies, including the FDIC, to prepare a strategic plan that broadly defines each agency's mission, vision, and strategic goals and objectives; an annual performance plan that translates the vision and goals of the strategic plan into measurable annual goals; and an annual performance report that compares actual results against planned goals.

The Corporation's strategic plan and annual performance plan lay out the agency's mission and vision and articulate goals and objectives for the FDIC's three major program areas: Insurance, Supervision, and Receivership Management. The plans focus on four strategic goals that define desired outcomes identified for each program area: (1) Insured Depositors Are Protected from Loss Without Recourse to Taxpayer Funding, (2) FDIC-Supervised Institutions Are Safe and Sound, (3) Consumers' Rights Are Protected and FDIC-Supervised Institutions Invest in Their Communities, and (4) Recovery to Creditors of Receiverships Is Achieved. Through its annual performance report, the FDIC is accountable for reporting actual performance and achieving these strategic goals. In addition to the Corporation's strategic and annual goals and objectives established under GPRA, the Chairman maintains a comprehensive set of objectives used for internal management which are summarized in terms of Stability, Sound Policy, and Stewardship.

The Corporation has made significant progress in implementing the Results Act and needs to continue to address the challenges of developing more outcome-oriented performance measures, linking performance goals and budgetary resources, implementing processes to verify and validate reported performance data, and addressing crosscutting issues and programs that affect other federal financial institution regulatory agencies.

10. <u>Cost Containment and Procurement Integrity</u>

As steward for the Bank Insurance Fund and Savings Association Insurance Fund, the FDIC seeks ways to limit the use of those funds. Therefore, the Corporation must continue to identify and implement measures to contain and reduce costs, either through more careful spending or assessing and making changes in business processes to increase efficiency. Many of the efforts described earlier as part of other management and performance challenges (e.g., New Financial Environment (NFE), service costing, corporate downsizing) attest to the Corporation's ongoing efforts to contain and reduce costs.

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A key challenge to containing costs relates to the contracting area. To assist the Corporation in accomplishing its mission, contractors provide services in such areas as information technology, legal matters, loan servicing, and asset management. To achieve success in this area, the FDIC must ensure that its acquisition framework—that is, its policies, procedures, and internal controls—is marked by sound planning; consistent use of competition; fairness; well-structured contracts designed to produce cost-effective, quality performance from contractors; and vigilant contract management to ensure successful oversight management activities.

The Corporation has taken a number of steps to strengthen internal control and effective oversight. However, our work in this area continues to show that further improvements are necessary to reduce risks such as the consideration of contractor security in acquisition planning, incorporation of information security requirements in FDIC contracts, and oversight of contractor security practices. Other risks include corporate receipt of billings for such items as unauthorized subcontractors, unallowable subcontractor markups, incorrect timesheets, billings for unreasonable project management hours, conflicts of interest, and unauthorized labor categories. The combination of increased reliance on contractor support and continuing reductions in the FDIC workforce presents a considerable risk to the effectiveness of oversight management activities.