



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

August 5, 2010

Neil M. Barofsky
Special Inspector General
Office of the Special Inspector General for the Troubled Asset Relief Program
1500 Pennsylvania Ave., NW, Suite 1064
Washington, D.C. 20220

RE: Follow-Up on Compliance Recommendations in the SIGTARP Audit Report

Dear Mr. Barofsky:

The Department of the Treasury (Treasury) has carefully reviewed the audit report by the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) entitled "Treasury's Monitoring of Compliance with TARP Requirements by Companies Receiving Exceptional Assistance" and the recommendations therein. This letter supplements our initial response letter dated June 29, 2010 regarding your recommendations regarding compliance activities of the Office of Financial Stability (OFS).

We agree with your objective, which is to improve how we monitor compliance with TARP contractual requirements by exceptional assistance recipients, and with some elements of the various recommendations. We disagree, however, with certain statements and conclusions made in the audit report. Insofar as these are the basis for the recommendations, we wish to point out our key concerns. Therefore, before turning to the specific recommendations, we believe it is important to briefly review the status of the companies that have received exceptional assistance and how the compliance issues that are the focus of your report fit into the larger picture of what Treasury is doing to protect the taxpayer and fulfill its responsibilities under the Emergency Economic Stabilization Act of 2008 (EESA). In this regard, we wish to highlight three issues: the overall status of efforts to recover exceptional assistance funds, the substance of the compliance requirements, and how Treasury's compliance efforts relate to other activities with regard to these companies.

First, when the Obama Administration took office, there were seven companies that had received exceptional assistance from the previous Administration: American International Group (AIG), Bank of America, Chrysler Holdings LLC, Chrysler Financial, Citigroup, General Motors and General Motors Acceptance Corporation. Since the Obama Administration took office, no additional companies have received exceptional assistance, and three of the original seven companies -- Bank of America, Chrysler Financial and Citigroup-- have paid back the exceptional assistance. In the case of these three companies, not only have taxpayers been repaid the exceptional assistance amounts, they have also earned a profit on those investments. Today, four companies still have exceptional assistance, and we wish to recover those funds as soon as practicable, in a manner consistent with our responsibilities under EESA.

Second, the focus of your audit is compliance with the contractual restrictions established by the previous Administration, which pertain to (1) executive compensation, (2) corporate expenditure and lobbying policies and (3) certification requirements as to internal controls. With respect to executive compensation, the contractual provisions were modified substantially by legislative developments, and as a result the focus of our compliance efforts also shifted. Specifically, the original exceptional assistance contracts implemented Section 111 of EESA required Treasury to impose certain standards on recipients of assistance. However, Congress revised the original EESA requirements and replaced them with more comprehensive standards in the American Recovery and Reinvestment Act of 2009 (ARRA), which was signed into law on February 17, 2010. Treasury implemented these requirements through the detailed provisions of the Interim Final Rule which was released in June 2009. The IFR created the Office of the Special Master to implement these requirements with respect to those companies that had received exceptional assistance.

Treasury's compliance effort focused, in large part, on the implementation of these new standards. Shortly after the passing of ARRA, Treasury arranged for the staffing of the Office of the Special Master, which included key staff from the OFS Compliance Department including two senior executive compensation specialists each with more than 20 years of experience and two executive compensation analysts with audit backgrounds. Staff of OFS then worked closely with the Office of the Special Master to execute the requirements imposed on the exceptional assistance companies.

These facts are part of the broader context in which your report should be considered. For example, your report criticizes Treasury for not conducting a "retrospective review" of compliance by companies even after they had repaid exceptional assistance. Treasury believed it was not a wise use of taxpayer dollars to continue such a retrospective review once a company had repaid the funds and was no longer a recipient of exceptional assistance. While compliance with these contractual requirements is important, we believe a central objective in overseeing investments made with taxpayer dollars is to try to recover the funds in a manner consistent with the goal of promoting financial stability. In these cases, that objective was achieved: the exceptional assistance funds were paid back with a gain to the taxpayer.

Similarly, your report criticizes Treasury for the pace with which it initiated compliance reviews of the various companies. While we do not argue with most of the facts as to when particular reviews were implemented, we believe the report fails to put proper emphasis on the efforts Treasury made to implement the executive compensation requirements of ARRA as discussed above. Treasury believed that the critical task was to implement the Congressional intent reflected in these provisions. In this regard, the publication of the IFR provided useful guidance to compliance staff at the companies. Treasury also took steps to insure compliance with the other contractual requirements.

Finally, while the scope of your audit was limited to Treasury's efforts to monitor compliance over specific restrictions contained in the agreements between Treasury and the companies that have received exceptional assistance, these efforts should be considered in light of each company's specific situation and the other actions that are being taken to protect the taxpayer with respect to these investments.

For example, Treasury's compliance monitoring with respect to Citigroup was not limited to Citigroup's adherence to the exceptional assistance contractual provisions. Treasury spent significant time and resources evaluating Citigroup's internal controls as part of the Asset Guarantee Program (AGP). Due to its size, structure and potential impact on the financial system as a whole, the AGP was the program to which OFS devoted much of its compliance resources. Other activities performed by OFS Compliance over Citigroup in connection with the AGP included recommending enhancements to the asset verification and management processes, evaluating Citigroup's internal audit process, consulting on compliance and auditing requirements contained in the contractual agreements with Citigroup, and advising Citigroup and other respective Federal Government officials on the scope and approach for Citigroup's required annual attestation. It is also important to note that the AGP was terminated by Citigroup at a profit to the taxpayer. The report largely ignores this interaction.

Additionally, Treasury believes its compliance efforts with respect to these contractual provisions should not be viewed in isolation, but in the context of other efforts to protect the taxpayer with respect to these investments. Treasury personnel spend substantial time monitoring the companies—particularly those that are not subject to extensive federal regulation as is the case with Citigroup and Bank of America—including with respect to their financial health. For example, significant Treasury resources were dedicated to reviewing information provided by General Motors and Chrysler to determine their viability and their organizational structures and leadership through the time the organizations were restructured in June 2009 and in setting upfront requirements that would help ensure viability. Treasury's auto team continues to monitor performance of these entities and to explore how and when the government should divest its ownership. In addition, Treasury and OFS personnel are in continuing dialog with AIG regarding the organization's financial condition, leadership, business objectives, and governance processes. These individuals also monitored compliance with specific reporting requirements under their TARP agreements.

The remainder of this letter responds more fully to the recommendations in your report and provides a detailed description of the measures we are employing to address the underlying concerns that you raised.

Recommendation 1: Treasury should promptly take steps to verify TARP participants' conformance to their obligations, not only by ensuring that they have adequate compliance procedures but also by independently testing participants' compliance.

We agree with the need to test compliance and will engage in such testing in the future. We wish to clarify how we determine where to engage in such testing so that you understand our compliance priorities.

Our strategy is to conduct testing where we have particular concerns as to risk; we believe this is a better use of resources, and consistent with widely accepted auditing practices, than random testing. (We assume you would agree but because the report was not clear on this issue, we wish to clarify it.) Circumstances that would lead us to conclude that testing is warranted would include but not be limited to the following: (1) if we have concern that, based on our overview, the exceptional assistance recipient did not have an independent and reliable process to assess the effectiveness of internal controls, (2) if OFS Compliance, after review of the recipient's internal control assessments, believed that the scope of such assessments were insufficient or (3) if OFS

Compliance concluded that the scope of the recipient's internal control assessments did not adequately test compliance with TARP requirements in a sufficient manner.

These concerns can arise in the course of conducting our standard compliance procedures. Treasury verifies TARP participants' compliance with contractual requirements by using industry accepted standards for internal controls and governance assessments. For example, we use those promulgated by the Public Company Accounting Oversight Board (PCAOB) and American Institute of Certified Public Accountants (AICPA). OFS Compliance reviews management's evaluation of its controls, including identifying the company officials involved in this process, how often these controls are tested for effectiveness, and the scope and approach of such evaluation. OFS Compliance, through inquiry and walkthrough or review of one or more control effectiveness reports and associated work papers, determines whether (1) the work was performed by an independent party with the appropriate capabilities, (2) the scope and approach was appropriate to evaluate the effectiveness of the controls, as well as (3) the conclusions regarding controls' effectiveness were supported by the work performed and documented. In general, the internal audit function has been the primary evaluator for the effectiveness of these organizations' TARP related controls.

We believe this audit approach to the recipient's controls and adherence to the TARP requirements is a proper way to mitigate risk and a more efficient use of taxpayer resources than a non-strategic approach. Of course, if there are other particular circumstances you believe we should consider, we are happy to entertain those.

Recommendation 2: Treasury should develop guidelines that apply consistently across TARP participants for when a violation is sufficiently material to merit reporting, or in the alternative, require that all violations be reported.

Treasury believes it already complies with the spirit of this recommendation but recognizes the value of memorializing its approach and therefore will work on doing so. That is, OFS Compliance communicates the process for evaluating and reporting violations with TARP requirements when engaging with company officials during its government framework assessments. As stated in the report, OFS Compliance has made suggestions to appropriate officials at these organizations for identifying and reporting violations with TARP requirements, which they have since adopted. For example, your report references OFS Compliance's interaction with AIG in this regard.

Treasury recognizes that formally articulating an internal policy could be valuable in ensuring consistency. Treasury will consider developing internal procedures to ensure that OFS Compliance implements a similar approach among institutions for communicating when to report violations to OFS. We are concerned about creating an inflexible regime where different institutions could not be evaluated in the context of their necessarily different environments, and therefore will seek to develop and articulate procedures that address this concern. We will keep your staff informed as we articulate a formal policy that addresses your concerns but also preserves our ability to respond to differing situations.

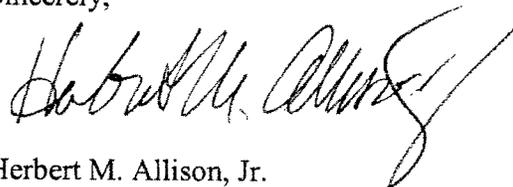
Recommendation 3: SIGTARP reiterates its previous recommendation concerning the need to add enough infrastructure and staff at OFS-Compliance to ensure TARP recipients' adherence to their compliance obligations.

As previously discussed with your staff, Treasury recognizes the need to continue to hire additional staff in OFS Compliance to fully execute its existing compliance strategy and continues to aggressively recruit. We provided a description of our hiring efforts and challenges to your staff that were not accurately reflected in your report.

Your report is highly critical of our hiring efforts and states that “[T]reasury simply has no legitimate excuses as to why it has still failed to...assembl[e] a robust compliance staff.” We believe this is an unfair and inaccurate criticism. OFS Compliance has aggressively recruited candidates; but hiring continues to be challenged because there is a demand for individuals with the required skills and offers can be declined due to salary constraints and the limited employment period for the position. Moreover, as stated in the first part of the letter, OFS's efforts with respect to compliance are broader than the focus of your report.

We share your commitment to internal controls in all of TARP's programs and policies. We look forward to continuing to work with you and your team as we continue our efforts to stabilize our financial system.

Sincerely,



Herbert M. Allison, Jr.
Assistant Secretary for Financial Stability