

August 1988

FINANCIAL AUDIT

Federal Home Loan
Bank Board's 1987
and 1986 Financial
Statements



043077

Comptroller General
of the United States

B-114893

August 24, 1988

To the President of the Senate and the
Speaker of the House of Representatives

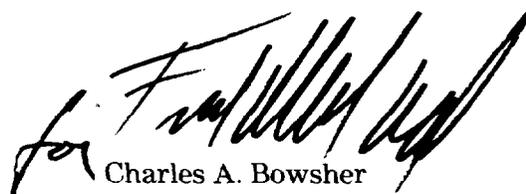
This report presents our opinion on the Federal Home Loan Bank Board's financial statements for the years ended December 31, 1987 and 1986, and our reports on the Bank Board's system of internal accounting controls and on its compliance with laws and regulations.

Our opinion discusses the Bank Board's change in the useful life used to depreciate its furniture, fixtures, and equipment. This change resulted in a \$2 million reduction of furniture, fixtures, and equipment and a corresponding increase to depreciation expense in 1987. As a result, the Bank Board's 1987 net income was significantly lower than its 1986 net income.

The Federal Home Loan Bank Board is an independent agency in the executive branch that formulates policies for and supervises the operations of the 12 Federal Home Loan Banks, the Federal Savings and Loan Insurance Corporation, and the system of federal savings and loan associations. On July 5, 1988, we issued a qualified opinion on the Corporation's financial statements (GAO/AFMD-88-58) and disclosed that the Corporation is insolvent.

The Bank Board, under 12 U.S.C. 1438(c)(6), is subject to the audit provisions applicable to wholly owned government corporations, 31 U.S.C. 9105, under which the Comptroller General audits the financial transactions of such corporations. We conducted our examinations in accordance with generally accepted government auditing standards.

We are sending copies of this report to the the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Chairman of the Federal Home Loan Bank Board.



Charles A. Bowsher
Comptroller General
of the United States

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Comptroller General
of the United States

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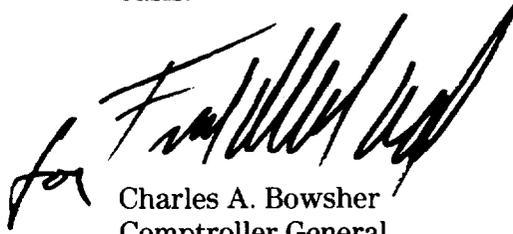
To the Chairman
Federal Home Loan Bank Board

We have examined the statements of financial condition of the Federal Home Loan Bank Board as of December 31, 1987 and 1986, and the related statements of income and expenses and retained earnings, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. In addition to this report on our examination of the Bank Board's 1987 and 1986 financial statements, we are also reporting on our study and evaluation of internal accounting controls and compliance with laws and regulations. During our examination, we identified matters that do not affect the fair presentation of the financial statements, but nonetheless warrant management's attention. We are reporting them separately to the Bank Board.

This opinion applies only to the Bank Board's financial statements. The Bank Board formulates policies for and supervises the operations of several related organizations, including the Federal Savings and Loan Insurance Corporation. On July 5, 1988, we issued a qualified opinion on the Corporation's financial statements (GAO/AFMD-88-58) and disclosed that the Corporation is insolvent.

In September 1987, the Bank Board retroactively revised the estimated useful life used to depreciate its furniture, fixtures, and equipment, shortening it from 11 years to 4 years. In addition, as of September 1987, instead of capitalizing all purchases in excess of \$1,000, the Bank Board expenses all those items below \$5,000 and capitalizes and depreciates only those items that exceed this limit. Using the revised useful life will result in a reduction in the furniture, fixtures, and equipment account of more than \$5 million over the next 3 years. The 1987 financial statements reflect a \$2 million reduction of furniture, fixtures, and equipment and a corresponding increase to depreciation expense. As a result, the Bank Board's 1987 net income was significantly lower than its 1986 net income.

In our opinion, the financial statements referred to above present fairly the financial position of the Federal Home Loan Bank Board as of December 31, 1987 and 1986, and the results of its operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

A handwritten signature in black ink, appearing to read "for Charles A. Bowsher". The signature is written in a cursive, somewhat stylized script.

Charles A. Bowsher
Comptroller General
of the United States

May 17, 1988

Report on Internal Accounting Controls

We have examined the financial statements of the Federal Home Loan Bank Board for the years ended December 31, 1987 and 1986, and have issued our opinion thereon. As part of our examinations, we made a study and evaluation of the system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. This report pertains only to our study and evaluation of the system of internal accounting controls for the year ended December 31, 1987. Our report on the study and evaluation of internal accounting controls for the year ended December 31, 1986, is presented in GAO/AFMD-87-42, dated June 9, 1987.

The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Bank Board's financial statements. For purposes of this report, we have classified the significant internal accounting controls into the following categories:

- expenditures,
- financial reporting,
- revenue, and
- treasury.

Our study and evaluation only included the controls in the expenditures category. For the financial reporting, revenue, and treasury categories, we found it more efficient to rely solely on substantive audit tests because of the limited number of transactions involved. In addition, we reviewed the Bank Board's latest vulnerability reports issued pursuant to section 2 of the Federal Managers' Financial Integrity Act of 1982 to determine the existence and status of any internal accounting control weaknesses relevant to financial matters.

The Bank Board's management is responsible for establishing and maintaining an effective system of internal accounting controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system of internal accounting controls are to provide management with reasonable assurance that (1) obligations and costs are in compliance with applicable laws, (2) funds, property, and assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenditures applicable to operations are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain

accountability over the Bank Board's assets. Because of inherent limitations in any system of internal accounting controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation, made for the limited purpose described above, would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the Bank Board's system of internal accounting controls taken as a whole or on the categories of controls identified in the second paragraph. Our study and evaluation did not disclose any internal accounting control weaknesses which we considered to be material in relation to the financial statements taken as a whole.

During our examination, we identified internal accounting control matters which, although not material, nonetheless merit corrective action to strengthen the Bank Board's internal accounting controls. Accordingly, we are reporting them separately to the Bank Board.

Report on Compliance With Laws and Regulations

We have examined the financial statements of the Federal Home Loan Bank Board for the years ended December 31, 1987 and 1986, and have issued our opinion thereon. Our examinations were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of compliance with laws and regulations as we considered necessary in the circumstances. This report pertains only to our review of compliance with laws and regulations for the year ended December 31, 1987. Our report on compliance with laws and regulations for the year ended December 31, 1986, is presented in GAO/AFMD-87-42, dated June 9, 1987.

As part of our examination, we reviewed and tested compliance with the Competitive Equality Banking Act of 1987, the Prompt Payment Act, the Federal Managers' Financial Integrity Act of 1982, the Federal Home Loan Bank Act of 1932, and such other laws and regulations as we considered pertinent to the Bank Board. In our opinion, the Bank Board complied with the terms and provisions of laws and regulations for the transactions tested that could have materially affected the financial statements. Nothing came to our attention in connection with our examination that caused us to believe that the Bank Board was not in compliance with the terms and provisions of applicable laws and regulations for those transactions not tested. However, we are currently evaluating a compliance matter that merits discussion.

An April 30, 1987, report, Federal Pay: Executive Salaries in Government-Related Banking Organizations (GAO/GGD-87-68FS), identified several organizations within the Federal Home Loan Bank system that operate under the Bank Board's direction but which, unlike the Bank Board itself, do not regard their employees as federal employees subject to the salary limitations of title 5, United States Code. In light of the information contained in that report, the Chairman of the Subcommittee on Federal Services, Post Office, and Civil Service, Committee on Governmental Affairs, United States Senate, requested that, among other items, we examine whether the Bank Board's "actions in divesting itself of certain functions in favor of establishing entities that consider themselves not subject to the title 5 salary limitations are lawful and proper." Accordingly, we are examining this issue with regard to five Bank Board-related entities—the Office of Regulatory Policy, Oversight, and Supervision (recently renamed the Office of Regulatory Activities); the Office of Finance; the Federal Asset Disposition Association; the Federal Home Loan Bank system Publication Corporation; and the Office of Education.

Financial Statements

Statement of Financial Condition

DECEMBER 31, 1987 AND 1986
(in thousands)

	<u>1987</u>	<u>1986</u>
<u>Assets</u>		
Cash with U. S. Treasury.....	\$ 524	\$ 749
Accounts receivable (Note 2).....	8,420	8,694
Land and building (Note 1).....	43,919	42,566
Furniture, fixtures and equipment (Note 1)....	3,058	5,873
Other assets.....	<u>0</u>	<u>39</u>
Total assets.....	55,921	57,921
	=====	=====
<u>Liabilities</u>		
Accounts payable and accrued liabilities	844	2,912
Employees' accrued annual leave.....	<u>1,372</u>	<u>1,122</u>
Total liabilities.....	<u>2,216</u>	<u>4,034</u>
<u>Capital</u>		
Retained earnings.....	12,675	12,857
Paid in capital	<u>41,030</u>	<u>41,030</u>
Total capital (Note 4).....	<u>53,705</u>	<u>53,887</u>
Total liabilities and capital.....	\$ 55,921	\$ 57,921
	=====	=====

The accompanying notes are an integral part of these financial statements.

Financial Statements

Statement of Income and Expenses and Retained Earnings

FOR THE YEARS ENDED DECEMBER 31, 1987 and 1986
(in thousands)

	<u>1987</u>	<u>1986</u>
<u>Income</u>		
Assessments:		
Federal Home Loan Banks..... \$	8,071	\$ 8,268
Federal Savings and Loan Insurance Corporation..	25,603	24,819
Gain on sale of land (Note 1).....	0	9,176
Rent and miscellaneous other.....	<u>1,487</u>	<u>1,872</u>
Total income.....	35,161	44,135
	=====	=====
<u>Expenses</u>		
Personnel compensation.....	17,752	15,679
Personnel benefits (Note 3).....	2,830	2,118
Travel and transportation.....	901	942
Rent, communication, and utilities.....	3,057	3,245
Depreciation:		
Furniture, fixtures, and equipment.....	2,816	1,085
Building.....	939	905
Return of gain on sale of land to FHLBanks (Note 1).....	0	9,176
Building maintenance and other services.....	<u>7,048</u>	<u>6,533</u>
Total expenses.....	35,343	39,683
	=====	=====
Net income.....	(182)	4,452
Retained earnings at beginning of year (Note 4).....	<u>12,857</u>	<u>8,405</u>
Retained earnings at end of year (Note 4)	\$12,675	\$ 12,857
	=====	=====

The accompanying notes are an integral part of these financial statements.

Financial Statements

Statement of Changes in Financial Position

FOR THE YEARS ENDED DECEMBER 31, 1987 AND 1986
(in thousands)

	<u>1987</u>	<u>1986</u>
<u>Source of Funds</u>		
Net income (loss).....	\$ (182)	\$ 4,452
Adjustment for non-cash items:		
Depreciation.....	<u>3,755</u>	<u>1,990</u>
Funds provided from operations.....	3,573	6,442
Decrease in:		
Accounts receivable.....	274	(3,796)
Other assets.....	39	306
Increase in:		
Accrued annual leave.....	250	(314)
Sale of land (Note 1).....	0	3,064
Prior year adjustment to retained earnings	<u>0</u>	<u>99</u>
Total funds provided.....	<u>4,136</u> =====	<u>5,801</u> =====
<u>Application of Funds</u>		
Acquisition of capital assets	2,293	2,579
Decrease in:		
Accounts payable and accrued liabilities...	2,068	212
Reduction of paid-in-capital-sale of land (Note 1).....	<u>0</u>	<u>3,064</u>
Total funds applied.....	<u>4,361</u>	<u>5,855</u>
Decrease in cash.....	\$ (225) =====	\$ (54) =====

The accompanying notes are an integral part of these financial statements.

Notes to Financial Statements

DECEMBER 31, 1987 AND 1986

1. Summary of Significant Accounting Policies:

- a. Furniture, Fixtures, and Equipment (FF&E) - The FF&E cost at December 31, 1987 was \$12,368,137 less accumulated depreciation of \$9,310,405. The cost at December 31, 1986 was \$12,367,816 less accumulated depreciation of \$6,494,574. Depreciation was computed on the straight-line method based on an 11 year useful life. In September 1987 a review of the FF&E policy was made. It was determined that the new policy (which is subject to periodic review) would be that all FF&E up to \$5,000 would be expensed and that FF&E over \$5,000 would be capitalized and depreciated on the straight-line method over a 4 year useful life. This new policy change will result in a FF&E reduction of \$3,057,732 over a 2-year period - \$2,000,000 in 1988 and 1,057,732 in 1989.
- b. Land and Building - These assets are recorded at cost less accumulated depreciation for the building. Cost of land was originally \$10,165,227 and is now at \$7,101,112 because the parcel of land at 3rd and D Streets, N.W. Washington, D.C. was sold in September 1986. The proceeds from the sale (cost \$3,064,115 and gain \$9,175,884) were reimbursed to the 12 FHLBanks since they were originally assessed for the land purchase. Building costs at December 31, 1987 and 1986, were \$45,407,226 and \$43,114,511 less accumulated depreciation of \$8,588,934 and \$7,649,727 respectively. Depreciation for the building is computed on the straight-line method over 50 years.

2. Related Parties - The twelve District Federal Home Loan Banks (FHLBanks), together with their member institutions, comprise the primary components of the FHLBank System. In addition, their affiliated organizations - the Federal Savings and Loan Insurance Corporation, the Office of Regulatory Policy, Oversight and Supervision, the Federal Home Loan Mortgage Corporation, the Office of Finance and the Neighborhood Reinvestment Corporation - assist in carrying out the Bank System's mission. The FHLBank System is governed and regulated by the Federal Home Loan Bank Board (Bank Board) which is an independent Federal agency in the executive branch of government. The Bank Board is the chartering and regulatory authority for the federal savings and loan associations and federal mutual savings banks. Further, the Bank Board, through the Federal Savings and Loan Insurance Corporation (FSLIC), governs the insurance of accounts in savings and loan associations and mutual savings banks. Bank Board expenses are met through assessments from the FHLBanks (25 percent) and the FSLIC (75 percent). This income is recognized as

earned monthly; assessment income for the FHLBanks and the FSLIC for 1987 was \$8,071,260 and \$25,603,496 respectively.

3. Retirement Plan - Approximately 73% of the Bank Board's employees are covered by the Civil Service Retirement System (CSRS), which is currently two-tiered. For employees hired prior to January 1, 1984, the Bank Board withholds approximately 7 percent of their gross earnings. This contribution is then matched by the Bank Board and the sum is transferred to the Civil Service Retirement Fund, from which this employee group will receive retirement benefits. For employees hired on or after January 1, 1984, with more than five years of service (not necessarily continuous), the Bank Board withholds, in addition to Social Security withholdings, approximately 1.3 percent of their gross earnings, but matches such withholdings with a 7 percent contribution. At the point such earnings exceed the FICA maximum wages of \$43,800 for 1987, employees covered under this tier of CSRS are required to have 7 percent of their earnings withheld while the agency expense remains a 7 percent contribution. This second employee group will receive retirement benefits from the CSRS along with the Social Security System, to which they concurrently contribute. Beginning in January 1987, all employees hired since January 1, 1984, either as new employees or as having less than 5 years of accumulated service (with a break in service over one year) are included in the new Federal Employee Retirement System (FERS). For such employees the Bank Board withholds 1.3% of their gross earnings and matches those withholdings with a 14.8 percent contribution (through 10/10/87) and a 12.5% contribution effective 10/11/87. This group of employees will receive benefits from the FERS as well as the Social Security System to which they concurrently contribute. The retirement expenses incurred for all plans during calendar years 1987 and 1986 were \$1,381,947 and \$1,025,131 respectively.

Although the Bank Board funds a portion of pension benefits under both of the above Retirement Systems relating to its employees and makes the necessary payroll withholdings from them, the Bank Board does not account for the assets of either retirement plan nor does it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management for both Retirement Systems and are not allocated to the individual employers. Except for one retired employee who has health insurance through the Bank Board's own health plan, the Office of Personnel Management accounts for all health and life insurance programs for retired federal employees.

Financial Statements

4. Capital:

	(in thousands)	
	1987	1986
Retained Earnings at Beginning of Year	\$12,857	\$ 8,306
Prior Year Adjustment	0	99
Adjusted Beginning Retained Earnings	12,857	8,405
Net Income (Loss)	(182)	4,452
Retained Earnings at End of Year	12,675	12,857
Paid-in-Capital at Beginning of Year	41,030	44,094
Sale of Land (3rd and D Sts.) (Note 1)	-0-	(3,064)
Paid-in-Capital at End of Year	41,030	41,030
Total Capital at End of Year	\$ 53,705	\$53,887
	=====	=====

5. Litigation - At the end of 1987, four legal actions were pending that involved the Bank Board. Currently, it is not possible to predict the eventual outcome of the various actions. However, it is management's opinion that these claims will not result in liabilities to such an extent that they will materially affect the FHLBB's financial position.

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