



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

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ACCOUNTING AND FINANCIAL  
MANAGEMENT DIVISION

B-202052

DECEMBER 16, 1981

The Honorable E. F. Callahan  
Chairman, National Credit Union  
Administration Board

Dear Mr. Callahan:

Subject: Improvements Needed in the Accounting  
and Financial Management of the National  
Credit Union Administration (AFMD-82-21)

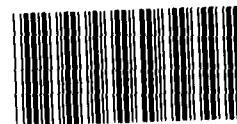
During our recent examination of the National Credit Union Administration's (NCUA's) 1980 financial statements, we tested NCUA's internal controls and the manner in which its accounting functions were performed. Our tests, based predominately on a judgmental sampling of transactions, disclosed numerous areas in which improvement can be made. The weaknesses we found in internal controls and accounting practices did not materially affect the financial statements taken as a whole. For this reason, we were able to render an unqualified opinion on NCUA's financial statements for calendar 1980.

We did not examine the adequacy of the share insurance fund in this review. However, credit unions have encountered severe financial difficulties during the past few years. If interest rates persist for an extended period at high levels, credit unions with total savings of \$2.1 billion as of May 1981 could face liquidation. Such an occurrence would represent a substantial liability to the National Credit Union Share Insurance Fund. We believe this potential liability emphasizes the need for improved accounting and financial management.

The purpose of this report is twofold: (1) to provide recommendations which we believe will improve the efficiency of NCUA's operations and the accuracy of its financial statements and (2) to help you discharge your responsibilities under 12 U.S.C. 1789 (b)2. This law requires NCUA to follow the principles and procedures applicable to commercial corporate transactions. These principles and procedures are commonly referred to as generally accepted accounting principles.

Under generally accepted accounting principles, the responsibility for reliable financial statements rests with management. In this respect, effective systems of accounts and internal control

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must be maintained. However, our tests of accounting practices and internal controls at NCUA disclosed that:

- Cash was not properly controlled through periodic reconciliations.
- Fixed assets were not properly controlled through periodic inventories.
- Uncollectible loans assumed from failed credit unions were not identified and written off.
- Unclaimed shareholders' moneys were not converted from an insured status to a noninsured status in accordance with current policies.
- Interest income was not recorded in the proper accounting period.
- Commercial bills and travel vouchers were not approved before payment, and employee duties related to voucher payments were insufficiently separated.
- Payroll data was not updated correctly, resulting in inaccuracies in the payroll system.

These weaknesses are discussed further in enclosure I.

During our field work, NCUA officials told us that some actions were being taken to strengthen NCUA's accounting and financial management policies and procedures. However, we recommend that you take additional steps to further strengthen NCUA's accounting and financial management by directing management to:

- Establish policies and procedures to monthly reconcile NCUA's cash accounts with U.S. Treasury records.
- Follow the stated policy of inventorying fixed assets biannually, preferably taking one of the inventories at the close of the fiscal year.
- Review loans acquired from failed credit unions and write off loans determined to be uncollectible.
- Follow up on NCUA's efforts to convert unclaimed shareholders' moneys from an insured to a noninsured status.
- Adhere to the procedures for recording interest income on the accrual basis.
- Prescribe procedures to record interest income waived on financial assistance loans and investments and provide full disclosure in the financial statements for material amounts of interest waived.

--Improve procedures to strengthen internal controls, including separation of duties over the audit, approval and certification of payments of commercial bills, and travel vouchers.

--Establish controls and procedures to ensure that pertinent employee personnel file information is provided to the General Services Administration payroll operations.

We would appreciate being informed, in writing, of the actions taken or planned to correct the weaknesses discussed in this report. Also, please be advised that section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement to (1) the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and (2) the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this report on actions taken on our recommendations.

We are sending copies of this report to the Chairmen of the above Committees; the Senate Committee on Banking, Housing, and Urban Affairs; and the House Committee on Banking, Finance, and Urban Affairs.

We appreciate the courtesies and cooperation extended to us by your staff during our examination.

Sincerely yours,



W. D. Campbell  
Acting Director

Enclosure

GAO OBSERVATIONS ON WEAKNESSES  
IN NCUA'S ACCOUNTING PRACTICES  
AND INTERNAL CONTROLS

Our examination of the National Credit Union Administration's (NCUA's) 1980 financial statements disclosed a need to improve accounting practices and internal controls. Inadequacies were found in accounting and controlling operating fund reimbursements from the share insurance fund, cash, fixed assets, uncollectible loans, unclaimed moneys, interest income, expense vouchers, and payroll data. When weaknesses in accounting practices and internal controls result in inaccurate accounting records, erroneous financial statements are produced and financial decisions are based on the incorrect data. These weaknesses are discussed below.

CONTROL OVER CASH NEEDS IMPROVEMENT

Cash is the asset most subject to misappropriation. For this reason, one of the most important internal control functions is giving special emphasis to the procedures for handling and accounting for cash. Losses can be avoided only by careful control of cash from the time it is received until the time it is spent. Our tests disclosed instances where NCUA had not properly controlled and accounted for cash. For example, at December 31, 1980, the operating fund cash account was overstated by about \$1,250 and the share insurance fund cash account was understated by about \$49,944. Also, NCUA's accounting records showed negative cash balances at the end of various months.

NCUA can disclose errors or irregularities existing in cash balances by periodically reconciling cash balances recorded with those on hand with the U.S. Treasury. However, NCUA's accounting manual does not require account reconciliations nor does it specify policies and procedures for reconciling accounts. As a result, NCUA's cash accounts were not reconciled with the U.S. Treasury records for over a year. Monthly reconciliations of cash accounts by NCUA will help identify discrepancies in cash balances. Accordingly, we recommend that NCUA establish policies and procedures for reconciling cash accounts monthly with U.S. Treasury records.

CONTROL OVER FIXED ASSETS  
NEEDS IMPROVEMENT

The importance of adequately accounting for property held by NCUA stems primarily from the fact that accountable funds are invested in such resources. This investment creates the need for management to be able to account for these resources and to use all appropriate techniques, including reliable financial information, to manage them properly, efficiently, and effectively.

Taking a physical inventory of property helps provide assurance that financial and quantitative information on property resources

is reliable. Although NCUA's accounting manual requires a biannual physical inventory of property, an inventory had not been taken for several years before the December 31, 1980, financial statement date. An inventory NCUA took during early 1981 disclosed discrepancies between property on hand and the property records. Although the discrepancies were insignificant when viewed in relation to NCUA's financial statements taken as a whole, we nevertheless believe the lack of physical inventories has weakened NCUA's internal control over its fixed assets which are valued at over \$1 million. We recommend, therefore, that NCUA follow its stated policy of inventorying fixed assets biannually, preferably taking one of the inventories at the close of the fiscal year.

UNCOLLECTIBLE LOANS NEED TO BE  
REVIEWED AND WRITTEN OFF

Under generally accepted accounting principles, receivables such as loans should be carried at their net realizable value. Net realizable value is the estimated amount expected to be collected (after providing for appropriate carrying and/or disposal costs). Almost invariably some receivables prove uncollectible. This is particularly significant to NCUA because, as an insurer of credit union members' share accounts, NCUA assumes assets and liabilities resulting from the closing of a failed insured credit union. Loans taken over by NCUA from failed insured credit unions amounted to \$19,339,691 at December 31, 1980.

Uncollectible loans have to be estimated if the loans acquired are to be stated at their estimated realizable amounts. The amount estimated to be uncollectible is recorded in an allowance account to avoid premature adjustments to the loan accounts. However, when evidence is available concerning the worthlessness of a loan, a charge should be made to the allowance account and the loans acquired account should be correspondingly reduced (credited). An example of evidence of worthlessness is the inability to locate a debtor. Although NCUA's accounting manual states that loans assumed from a failed credit union are to be reviewed semiannually to determine their values and to make appropriate adjustments to the accounts, this was not being done regularly.

In previous reports we have commented on the need to write off uncollectible loans. In our May 23, 1977 report, "Examination of Financial Statements of NCUA for Fiscal Years Ended 1976 and 1975," FOD 77-6, we recommended that steps be taken to identify and write off loans that were uncollectible. As a result, during 1976 and 1977 NCUA wrote off almost 17,000 loans amounting to about \$5 million. Also, in our August 14, 1978, report, "Examination of Financial Statements of NCUA for the 15 Months Ended September 30, 1977," FOD 78-2, we pointed out that at September 30, 1977, 3,412 loans were delinquent and considered uncollectible. In that report we noted that NCUA predicted that all uncollectible loans would be written off by December 31, 1978.

Despite our repeated attempts to encourage NCUA to eliminate uncollectible loans, significant amounts are still in the accounts. For instance, the share insurance fund's balance sheet at September 30, 1977, included \$7,127,737 as loans acquired from failed credit unions with a related allowance for doubtful accounts of \$4,578,771. At December 31, 1980, loans acquired from failed credit unions had increased to \$19,339,691, and the reserve for doubtful accounts had increased to \$14,366,168. The substantial increase in both the asset account and the reserve account indicated that NCUA had not been identifying and writing off uncollectible loans as we had previously recommended and as NCUA had indicated it would.

To test the extent of uncollectible loans and the accuracy of the balance in the loans acquired from failed credit unions, we selected a random sample of 400 loans valued at \$1,033,592 from the 21,242 loans valued at \$23,125,503 at October 30, 1980. We requested the borrowers of these loans to confirm their balances.

We received replies from 128 borrowers, having loans totaling \$429,179 or 41.5 percent of the amount in our sample. The remaining 272 requests, representing loans valued at \$604,413 or 58.5 percent of the amount in our sample were either undeliverable or unanswered. We estimate, at the 95-percent confidence level, that the loans acquired from failed credit unions for which borrowers cannot be located are valued between \$14,280,955 and \$18,436,365. For this reason, we recommend that NCUA review loans acquired from failed credit unions and write off loans determined to be uncollectible.

UNCLAIMED MONEYS SHOULD BE  
CONVERTED TO A NONINSURED STATUS

Unclaimed moneys are amounts owed to shareholders who failed to claim their funds within 18 months after their credit union was closed. In accordance with section 1787(h) of the Federal Credit Union Act (12 U.S.C. 1751 et seq.), if any member of the closed credit union fails to claim his insured account within 18 months, all rights of the member against the Board with respect to the insured account are barred. NCUA's accounting manual in effect at the time covered by our review, stated that after the 18-month period, the shareholders' accounts should be converted from an insured status to a noninsured status. Under this procedure a prorata portion of the shares not claimed were to be recorded in the share insurance fund as credit or as reduction of the liquidation expenses incurred. Unclaimed moneys were then to be placed in trust at the U.S. Treasury.

As of December 31, 1980, we found that \$301,864 of a total of \$356,133 in the unclaimed moneys account should have been transferred to the U.S. Treasury. If NCUA does not convert shareholders' accounts from an insured status to a noninsured status promptly, errors are more likely to occur in claim payments. Also, NCUA

was failing to recognize the adjustment to the liquidation expenses of the share insurance fund which stems from its prorating of moneys not claimed.

An NCUA official stated that staff constraint caused the large number of cases not to be transferred. The official also informed us that the NCUA staff is in the process of reviewing outstanding cases and improving automation of the system for handling this account. Since the time of our review, NCUA has changed some of its policies regarding the handling of unclaimed moneys. Beginning in September 1981, the funds are being retained by NCUA rather than being sent to the U.S. Treasury. Other changes in policy for handling these accounts are also being considered. Regardless of how the procedures are changed, however, it is important that the procedures be properly executed to reduce errors and provide proper financial management.

#### INTEREST INCOME SHOULD BE ACCRUED IN PROPER ACCOUNTING PERIOD

To prevent the closing of a financially troubled insured credit union, NCUA provides financial assistance by making loans to or investing funds in the credit union. Both generally accepted accounting principles and NCUA's accounting manual require that interest on loans to or on investments in the credit unions be recorded by NCUA when earned. This is the accrual basis of accounting. The earning of interest is a function of time and should be recognized in the accounting period to which it is attributed without regard to when NCUA collects the interest. Our examination of the interest income account showed that it was overstated by \$165,113, representing income earned in 1979 but not recorded until February and June 1980. It also showed that some 1980 income had not been recorded and that in one instance the unrecorded income had been waived.

To improve the accounting treatment of interest income, we recommend that NCUA adhere to the accrual basis for recording interest income and prescribe procedures to record interest income waived. NCUA officials are aware of the problem and told us they are taking steps to correct it.

#### CONTROL OVER PAYMENTS NEEDS IMPROVEMENT

An effective internal control system requires approval, certification, and administrative audit of vouchers before payment. Our review of NCUA's payment procedures showed that (1) administrative audits of commercial bills were inadequate, (2) travel vouchers were paid without prior approval and certification by responsible officials, and (3) weaknesses exist in the separation of duties.

Payment vouchers are not properly audited, approved, and certified

NCUA did not have written procedures for approval and certification of vouchers before payment. To determine whether this has caused controls over commercial payments to be less than satisfactory, we selected 35 vouchers paid during September 1980. These vouchers represented 280 commercial payments.

We found that:

- 19 of the 280 payments, or about 7 percent, did not have bills, invoices, or other evidence to support the validity of the payments.
- 60 of the 280 payments, or about 21 percent, lacked evidence that the goods and services were received.
- 9 of the 280 payments, or about 3 percent, had erroneous invoice cost extensions and footings.

For example, a GSA motor pool billing had 18 charges, but only 8 vehicle tickets were attached to the billing. Two of the eight tickets did not relate to the charges on the billing. The billing contained five erroneous cost extensions, three overcharges, and two undercharges.

The above errors indicate a lack of effective internal control over payment of vouchers. NCUA's internal audit staff reported similar instances of deficiencies in prepayment audit procedures. To ensure proper handling of payments, we recommend that NCUA establish procedures to ensure each voucher is audited, approved, and certified before payment.

Travel vouchers are not audited before payment

NCUA's written procedures provide for the payment of travel vouchers before audit. Also, the procedures provide for payment based on unapproved and uncertified vouchers submitted directly to headquarters by examiners. The procedures call for any adjustments resulting from audit to be deducted from the traveler's next voucher.

These procedures do not conform to normal preaudit, approval, and certification practices and could result in unwarranted payments to travelers. Therefore, we recommend that NCUA establish procedures to require travel vouchers to be audited and certified before payment.

Better separation of duties needed

One of the basic principles of internal control is dividing the critical functions between two or more persons, a technique



often referred to as separation of duties. Errors are more likely to be detected when duties are separated, and fraud is less likely when its perpetration depends upon collusion. Although NCUA's accounting principles and procedures call for a segregation of responsibilities, we noted that the voucher payment schedules were approved and certified by accounting personnel who had direct access to the accounting records and who also approved journal entries to the accounts.

The absence of separation of duties over voucher payments is a serious situation. Unless the approval and certification functions are performed by persons other than those who have access to the accounting records, the funds of NCUA will be susceptible to losses through fraud, waste, and abuse. Therefore, we recommend that NCUA establish procedures to ensure that persons who approve and certify vouchers do not have access to accounting records.

#### PAYROLL SYSTEM IS NOT UPDATED PROMPTLY

NCUA uses the General Service Administration's (GSA's) computerized payroll operations in Kansas City, Missouri, to prepare paychecks and to maintain its master payroll file. The responsibility for providing pertinent and reliable employee payroll information to GSA rests with NCUA. We determined, however, that NCUA does not have adequate controls and procedures for advising GSA of payroll changes.

We compared information contained in employee personnel files with NCUA payroll reports received from GSA to test the accuracy of the payroll computations. We judgmentally selected 36 of the 737 personnel files and compared them with the related payroll reports. Our comparison disclosed three instances where the information in an employee's personnel file did not agree with the employee's payroll record.

We recommend that NCUA improve the management of its payroll system by establishing controls and procedures to ensure that accurate information is provided to GSA for input into the payroll system.