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REPORT TO THE CONGRESS

Examination Of Financial Statements for the Year Ended December 31, 1973

B-114827

Federal Home Loan Bank Board

Federal Home Loan Banks

Federal Savings and Loan Insurance Corporation

Nov. - Dec 1974

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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NOV. 13, 1974

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114827

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

This is our report on the examination of the financial statements of the Federal Home Loan Bank Board, the Federal home loan banks, and the Federal Savings and Loan Insurance Corporation for the year ended December 31, 1973.

We made our examination pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53); the Accounting and Auditing Act of 1950 (31 U.S.C. 67); the Government Corporation Control Act, as amended (31 U.S.C. 850 and 857); and the Federal Home Loan Bank Act, as amended (12 U.S.C. 1431(j)).

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

Elmer B. Staats

Comptroller General
of the United States

Contents

ABBREVIATIONS

GSA General Services Administration

GAO General Accounting Office

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

EXAMINATION OF FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 1973
Federal Home Loan Bank Board
Federal Home Loan Banks
Federal Savings and Loan Insurance Corporation B-114827

D I G E S T

WHY THE EXAMINATION WAS MADE

The Government Corporation Control Act and the Federal Home Loan Bank Act require the Comptroller General to examine annually the financial transactions of the Federal home loan banks and the Federal Savings and Loan Insurance Corporation.

The Federal Home Loan Bank Board supervises the activities of the banks and the Corporation; therefore, GAO included the Board's financial statements in its examination.

As required by the Federal Home Loan Bank Act, as amended, GAO examined the accounts for calendar year 1973 relating to acquiring land in the District of Columbia and to constructing and equipping buildings on this land for use by the Board and the agencies under its supervision.

OPINION ON FINANCIAL STATEMENTS

In GAO's opinion, the Board's, banks', and Corporation's financial statements present fairly their financial positions at December 31, 1973, and their income and expenses and their changes in financial positions for the year then ended, in conformity with the principles and standards of accounting prescribed by the Comptroller General of the United States.

OTHER MATTERS OF INTEREST

Examination of Federal home loan banks

In recent years, the Board's Office of Audits experienced considerable difficulty in recruiting, training, and maintaining an adequate staff of field auditors to examine the Federal home loan banks due to extensive travel requirements.

Early in 1973, the Board engaged public accounting firms to make the annual audits of the banks under the direction of the Office of the Federal Home Loan Banks.

The public accounting firms audited the 12 banks' financial statements for the year ended December 31, 1973. (See p. 6.)

Supervision and examination of insured institutions

The Board through its Office of Examinations and Supervision supervises the insured institutions. Insured institutions are Federal savings and loan associations; building and loan, savings and loan, or homestead associations; and cooperative banks whose accounts are insured by the Corporation.

The Board's supervisory objectives are to obtain insured institutions' compliance with applicable laws and regulations and to avoid the development or continuance of unsafe or unsound financial practices by the institutions. Supervision is based on information obtained primarily through the Board's examinations of the insured institutions and the companies which have a controlling interest in the institutions and through independent accountants' audits.

During calendar year 1973, the Office of Examinations and Supervision examined 3,294 savings and loan institutions. The Board used the information to identify problem institutions. The most serious cases are classified as category I, financially critical, and the next most serious cases are classified as category II, not financially critical but requiring aggressive supervisory attention.

At December 31, 1973, there were 6 category I and 44 category II problem institutions with estimated insured deposits of $303 million and $2,010 million, respectively. (See p. 4.)

Acquisition of building site

The Federal Home Loan Bank Act, as amended on November 3, 1966, authorizes the Board to acquire a site and to construct buildings for use by the Board and the agencies under its supervision. The obligating authority to acquire a site and to construct and equip the buildings is $21.6 million.

The Board acquired a building site at 17th and G Streets NW., on August 24, 1973. Construction of the new headquarters building, however, was delayed due to a suit brought against the General Services Administration to stop demolition of the present buildings on the site. This suit alleged that the actions of the Administration were in violation of provisions of the National Historic Preservation Act, as amended. Although the suit is still pending to resolve certain questions of law, the Board has reached agreement with the plaintiffs to continue construction. (See p. 7.)

RECOMMENDATIONS OR SUGGESTIONS

This report contains no recommendations to the Board.

MATTERS FOR CONSIDERATION BY THE CONGRESS

This report is submitted to the Congress to disclose the results of the examination of the financial statements of the Board, banks, and Corporation and other information on their operations.

CHAPTER 1

INTRODUCTION

To make home ownership economical and to encourage thrift, the Congress, in the early 1930s, established three separate but interrelated organizations--the Federal Home Loan Bank Board, the Federal home loan banks, and the Federal Savings and Loan Insurance Corporation.

FEDERAL HOME LOAN BANK BOARD

The main purposes of the Board, an independent supervisory and regulatory agency, are to (1) regulate and supervise the operations of Federal home loan banks and the Federal Home Loan Mortgage Corporation, (2) direct the operations of the Federal Savings and Loan Insurance Corporation, (3) charter Federal savings and loan associations, and (4) regulate and examine institutions insured by the Federal Savings and Loan Insurance Corporation.

The Board is directed by a three-man board appointed by the President of the United States with the advice and consent of the Senate. (See appendix.) This three-man board also serves as the directors of the Federal Home Loan Mortgage Corporation, which provides a secondary market for residential mortgages. We have examined the Corporation's financial statements and will issue a separate report to the Congress.

FEDERAL HOME LOAN BANKS

The 12 banks, corporations chartered under the Federal Home Loan Bank Act, 12 U.S.C. 1421 et seq. (1970), provide reserve banking facilities to their member institutions--which may comprise savings and loan associations, savings banks, insurance companies, and others--and to certain nonmember borrowers.

The act provides that the Federal Home Loan Bank Board may create new Federal home loan banks--not more than 12 nor less than 8--and may liquidate or reorganize any Federal home loan bank. The locations of the headquarters for the 12 bank districts are as follows:

Boston, Massachusetts	Chicago, Illinois
New York, New York	Des Moines, Iowa
Pittsburgh, Pennsylvania	Little Rock, Arkansas
Atlanta, Georgia	Topeka, Kansas
Cincinnati, Ohio	San Francisco, California
Indianapolis, Indiana	Seattle, Washington

Each bank is operated under the direction of a board of directors, of which 4 members are appointed by the Federal Home Loan Bank Board and the remainder, ranging from 8 to 11, are elected by member institutions. The operating responsibility of each bank is vested in a president who is elected by the bank's board of directors subject to the approval of the Federal Home Loan Bank Board.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

The Corporation, a wholly owned Government corporation, insures withdrawable share and deposit accounts up to $20,000 for each insured member in all federally chartered savings and loan associations, all qualified State-chartered savings and loan associations, and similar institutions upon their request and approval by the Federal Home Loan Bank Board.

The Board carries out certain functions of the Corporation, such as processing applications for insurance and examining insured institutions. Other operating responsibilities, such as receivership activities and liquidation of assets, are vested in a director who is appointed by the Board. (See appendix.)

ECONOMIC IMPACT ON THE SAVINGS AND HOME FINANCING INDUSTRY

Historically, the savings and loan industry's operations have been influenced by the prevailing economic trends. During the first half of calendar year 1973, the industry completed an expansion cycle during which there was a tendency for associations to invest in higher risk assets.

In July 1973 the industry experienced a heavy net-savings outflow which signaled a downward trend. This trend coincided with an escalation in short-term interest rates, which induced many savers to transfer their funds into open-market instruments from savings accounts. Efforts to stem or reverse this net-savings outflow through the mechanism of interest rate competition for savings dollars will, with certainty, lower the profitability of institutions in the industry. Thus the dual problems--questionable asset quality during rapid expansion and lower profitability because of higher interest rate offerings--could create major problems for marginal associations.

The Board is aware of the current economic conditions affecting the industry and, in carrying out its responsibilities, has recognized a need for more thorough and frequent examinations of insured associations. To fulfill this responsibility, the Board has requested an additional 88 authorized examiner positions in fiscal year 1975.

CHAPTER 2

FEDERAL HOME LOAN BANK BOARD

The Board establishes policies for, and supervises the operation of, the following organizations.

Type of organization	Number	Total assets December 31, 1973 (billions)
Federal home loan banks	12	$ 19.9
Federal Savings and Loan Insurance Corporation	1	3.5
Federal savings and loan associations	2,040	152.2
Insured State-chartered savings and loan institutions	2,123	112.6
Federal Home Loan Mortgage Corporation	1	2.9
Total	4,177	$291.1

The Board's operations are financed by charges to savings and loan institutions to cover part of the cost of examinations and by assessments against the Federal home loan banks and the Corporation to cover administrative expenses and expenses incurred in supervising savings and loan institutions. The Congress placed limits on the amounts the Board could spend in fiscal year 1973--$8,900,000 for administrative expenses and $17,923,000 for nonadministrative expenses incurred in making regular examinations and in supervising insured institutions. Pub. L. No. 92-383, 86 Stat. 551. The Board's expenses were within the prescribed limits.

SUPERVISION AND EXAMINATION OF INSURED INSTITUTIONS

The Board through its Office of Examinations and Supervision supervises the insured institutions. Insured institutions are Federal savings and loan associations; building and loan, savings and loan, or homestead associations; and cooperative banks whose accounts are insured by the Corporation. In supervising State-chartered institutions, the Board coordinates its supervisory activities with those of the State supervisory authorities.

The Board's supervisory objectives are to obtain insured institutions' compliance with applicable laws and regulations and to avoid the development or continuance of unsafe or unsound financial practices by the institutions. Supervision is based on information obtained primarily through the Board's examinations of the insured institutions and the companies which have a controlling interest in the institutions and through independent accountants' audits.

The Board through its Office of Examinations and Supervision reviews the institutions' financial condition, compliance with applicable laws and regulations, and operating practices. It also reviews other matters of supervisory interest, such as reserve policies, potential losses, lending and loan collection policies, character of mortgage loans, earnings and expenses, and consistency of competitive practices with general standards of the savings and loan business.

In order to carry out its responsibilities, the Office of Examinations and Supervision had a professional staff of 624 as of December 31, 1973. This staff is in 12 district offices throughout the country and in its headquarters in Washington, D.C.

During calendar year 1973 the Office of Examinations and Supervision examined 3,294 savings and loan institutions. The Board used the information to identify problem institutions as discussed on pages 13 through 15. The Office of Examinations and Supervision also made 1,044 other examinations for such purposes as to approve the merger of two associations, to approve an institution's insurance eligibility requirements, and to insure compliance with the Board's regulations.

The examinations were made at intervals which averaged 15.5 months, a reduction from the calendar year 1972 average of 17 months. However, the Board's goal is to achieve an examination interval of 12 months.

As part of our review of the Office of Examinations and Supervision, we analyzed and reviewed reports and related documents pertaining to associations the Board classified as problem and nonproblem associations and discussed the results with appropriate officials. On the basis of our review, we found that problem associations were being recognized, the classification of problem and nonproblem associations appeared reasonable, and additional supervisory attention was given those associations experiencing problems.

OFFICE OF AUDITS

The Board's Office of Audits is responsible for making examinations and audits of the Federal Home Loan Bank Board, the Federal Savings and Loan Insurance Corporation, and the 12 Federal home loan banks. In recent years, the Office of Audits experienced considerable difficulty in recruiting, training, and maintaining an adequate staff of field auditors to examine the Federal home loan banks due to extensive travel requirements. Because of this, the Board expressed concern about the quality and timely issuance of reports. Early in 1973, the Board engaged a public accounting firm to review and evaluate the audit function. The review resulted in recommendations for improvements in many aspects of the Office's organization, policies, and procedures.

The Board believed that public accounting firms would provide less costly, higher quality audits of the 12 banks and more prompt reports. Therefore it engaged public accounting firms to make the annual audits of the banks under the direction of the Office of the Federal Home Loan Banks. The public accounting firms had completed audits of the 12 banks' financial statements for the year ended December 31, 1973.

During 1973 the Office of Audits examined the Federal Savings and Loan Insurance Corporation's financial statements for the year ended December 31, 1973, and the Board's financial statements for the fiscal year ended June 30, 1973.

We used, to the extent possible, the Office of Audit's reports on its examination of the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation and the public accounting firms' reports on the audits of the banks. By using these reports we were able to reduce the scope of our audits.

CONSTRUCTION OF NEW BUILDING

The Federal Home Loan Bank Act, as amended on November 3, 1966 (12 U.S.C. 1438(c)), authorizes the Board to use the services of the Administrator of General Services in acquiring real property in the District of Columbia and in constructing and equipping buildings for use by the Board and the agencies under its supervision.

The amendment to the act (Pub. L. No. 89-754, 80 Stat. 1293) provided that the Board (1) incur no obligations in excess of $13.2 million to acquire the land to construct and equip such buildings and (2) finance such acquisition of land and buildings from assessments against, or advances of funds by, the Federal home loan banks. The amendment provided also that we annually audit the accounts relating to acquiring land and to constructing and equipping buildings. On November 26, 1969, Public Law 91-126, 83 Stat. 240, authorized an increase in the obligating authority from $13.2 million to $21.6 million.

In 1968 the Board purchased through the General Services Administration (GSA) land on each side of Third Street between D and E Streets NW., Washington, D.C., for $5.5 million. In June 1970, shortly before GSA issued an invitation to bid for a contract for constructing the building, the Board instructed GSA to defer issuing the invitation until further notice.

In December 1970 the Board requested GSA to proceed with a feasibility study of acquiring another site for the building in Northwest Washington. The Board requested a new site because it wanted its building closer to the financial district and because it believed the acquired site was too small for a building large enough to meet the increased needs resulting from the creation of the Federal Home Loan Mortgage Corporation.

Early in 1972 GSA, acting as agent for the Board, sold part of the site to the U.S. Tax Court and optioned the remainder of the land to the District of Columbia.

The Board purchased the new building site at 17th and G Streets NW., on August 24, 1973, and initiated plans for the construction of a new headquarters building. Preparation for the construction of the new building, however, was delayed due to a suit brought against GSA to stop demolition of the present buildings on the site. The suit alleged that the actions of GSA were in violation of provisions of the National Historic Preservation Act, as amended (16 U.S.C. 470). Although the suit is still pending to resolve certain questions of law, the Board has reached agreement with the plaintiffs to continue construction.

As of December 31, 1973, the Board had transferred $12,783,200 to a fund account to be used by GSA for acquiring land and preparing for construction of the new building. Of this amount, $10,225,000 was advanced to the Board by the 12 Federal home loan banks and must be repaid in not more than 25 years. At December 31, 1973, the Board owed $8,869,680 to the banks.

SCOPE OF EXAMINATION

We reviewed:

1. The basic laws authorizing the Board's activities and the rules and regulations of the Board to ascertain the extent of its authority and responsibilities.

2. The examination and audit programs of the Board's Office of Examinations and Supervision and its Office of Audits to determine the adequacy of the prescribed procedures.

3. The reports, examinations, and audits to the extent deemed appropriate.

4. The Board's financial statements in accordance with generally accepted auditing standards. We also reviewed selected financial transactions and made such tests of the accounting records as we considered necessary.

CHAPTER 3

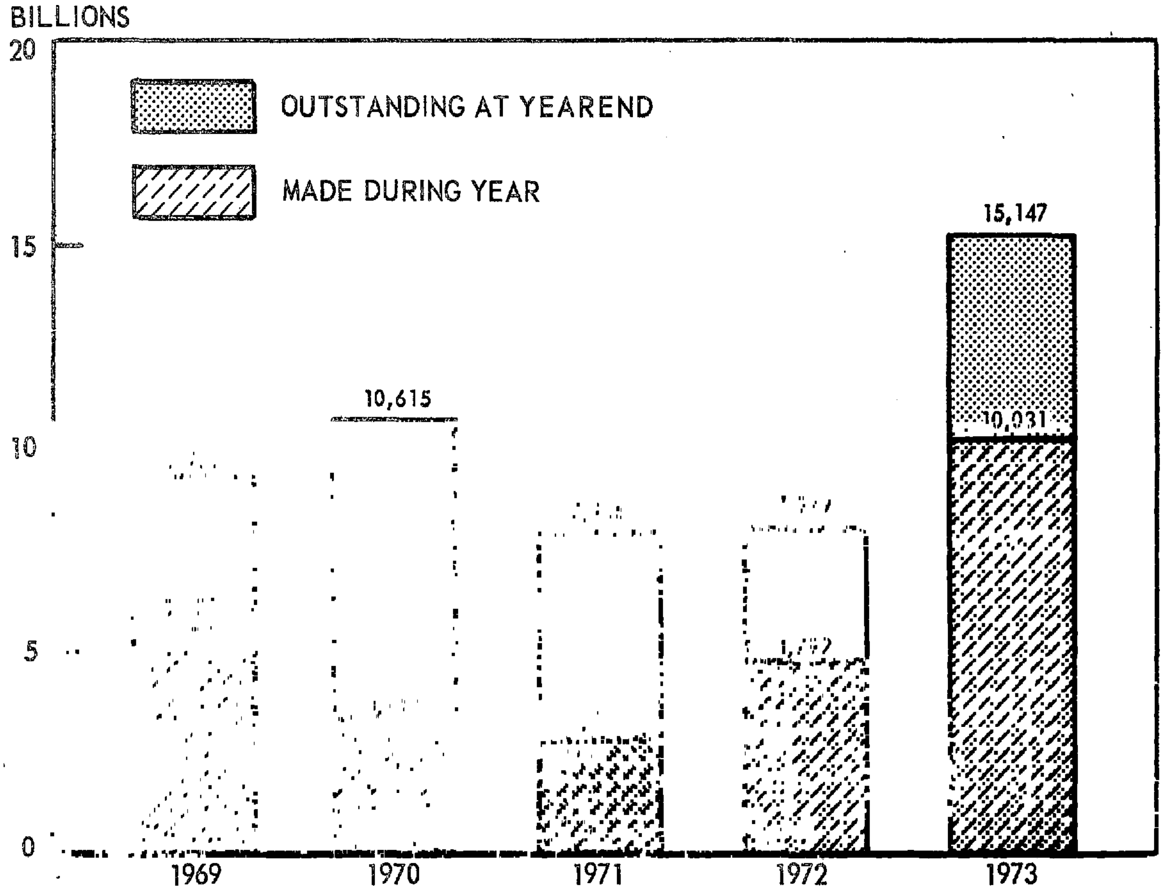
FEDERAL HOME LOAN BANKS

The banks' primary function is to make advances to, and accept deposits from, member institutions. Any building and loan association, savings and loan association, or savings bank is eligible to become a member of, or a nonmember borrower from, a Federal home loan bank if such institution makes long-term home mortgage loans and meets the other requirements of the Board. All institutions whose accounts are insured by the Federal Savings and Loan Insurance Corporation are members of a Federal home loan bank.

The banks obtain funds for lending activities from earnings, deposits by member institutions, subscriptions to capital stock, and the issuance of consolidated obligations. The banks' consolidated obligations are the joint and several liabilities of all the banks and are not guaranteed by the Government. Also, the banks can obtain funds through the Secretary of the Treasury, who has authority to purchase Federal home loan bank obligations up to $4 billion (12 U.S.C. 1431(i)); however, he had not exercised this authority through calendar year 1973.

During 1973 the banks advanced $10 billion to member institutions, compared with $4.8 billion in 1972. As a result of the economic conditions prevailing during 1973, funds advanced to institutions typically covered savings withdrawals and mortgage expansion. Advances repaid totaled $2.8 billion in 1973, compared with $4.7 billion in 1972. Of the $15.1 billion advances outstanding at December 31, 1973, $14.5 billion was secured by pledges of collateral consisting of home mortgages, capital stock of the banks, U.S. obligations, and other authorized collateral with a total face value of $26.7 billion. Following is a 5-year graphic presentation of the advances made by the banks during the year and advances outstanding at yearend.

Also during the year, the banks sold consolidated obligations of $10.6 billion and retired maturing obligations of $2.2 billion, which increased the balance of outstanding ob-



ligations from $7 billion at December 31, 1972, to $15.4 billion at December 31, 1973.

SCOPE OF EXAMINATION

We reviewed the Federal Home Loan Bank Act, as amended, and the Board's rules and regulations issued pursuant to the act to ascertain the policies and restrictions within which the banks are required to operate. We also reviewed the banks' lending and investment policies, financial reports and statements, and correspondence with the custodians of securities held at December 31, 1973.

The Board engaged independent public accounting firms to make the financial audits of the banks for calendar year 1973. Their examinations do not replace the audit required by our Office; however, we relied extensively upon their work. Our examination included a review of the adequacy of the firms' audit programs, prescribed procedures, and working papers.

CHAPTER 4

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

The Corporation insures withdrawable share and deposit accounts in all insured institutions, assesses and collects insurance premiums, and invests surplus funds. In addition, it may be appointed receiver of defaulted insured institutions. The Corporation also acts to prevent a default of an insured institution or to restore an institution in default to normal operation by making loans to, purchasing the assets of, or making a contribution to such an institution.

The Congress placed a limit of $550,000 on the amount the Corporation could spend in fiscal year 1973 for administrative expenses excluding supervisory and other services provided by the Board. Pub. L. No. 92-383, 86 Stat. 552. The Corporation's administrative expenses for fiscal year 1973 were within the limit.

PROBLEM INSTITUTIONS

To insure that insured institutions receive appropriate supervisory attention when needed, the Board's Office of Examinations and Supervision has developed procedures for rating each insured institution and for identifying those showing signs of weakness and trends which could later involve the Corporation.

The most serious cases are classified as category I, financially critical, and the next most serious cases are classified as category II, not financially critical but requiring aggressive supervisory attention. The number of problem institutions classified as categories I and II, which the Board follows closely, and the related estimated insured deposits are as follows:

Category	Number of institutions Dec. 31, 1973	Dec. 31, 1972	Estimated insured deposits Dec. 31, 1973	Dec. 31, 1972
			(000 omitted)	
I	6	14	$ 303,109	$ 517,323
II	44	47	2,009,894	2,483,029
	50	61	$2,313,003	$3,000,352

The Corporation's records showed that financial difficulties of institutions requiring its assistance during the year ended December 31, 1973, had been caused by unsafe and unsound operating practices, such as:

1. Excessive compensation of association management.
2. Concentration of lending on substandard security properties.
3. Excessive volume of out-of-State savings.
4. Making excessive loans on the basis of inflated appraisals.
5. Concentrating loans to a few speculative borrowers.

The Board and the Corporation encourage insured institutions to correct unsound operating practices and to aid institutions requiring financial assistance through contribution agreements. These agreements are negotiated between the participating parties and have a specific contract life. Although they are financially costly to the Corporation, they are less costly than the alternative receivership or voluntary liquidation.

During 1973 preventive actions were taken for five associations which were in critical financial condition. Four of the associations were merged and were the subject of financial assistance agreements and one was given an infusion of capital by new management under a financial assistance agreement.

ASSETS ACQUIRED THROUGH THE CORPORATION'S INSURANCE ACTIVITIES AND RELATED ALLOWANCE FOR LOSSES

At December 31, 1973, the Corporation held assets acquired in discharging its insurance indemnity liability to insured institutions and established an allowance for losses on these assets, as follows:

Asset	Book value	Allowance for losses	Net value
Assets acquired from insured institutions	$ 65,799,740	$13,912,649	$ 51,887,091
Loans to insured institutions and accrued interest	69,372,337	-	69,372,337
Subrogated accounts in insured institutions in liquidation	66,106,454	1,500,000	64,606,454
Total	$201,278,531	$15,412,649	$185,865,882

The allowance for losses is based on (1) the evaluations and judgments of Corporation officials who consider such data as actual losses experienced by the Corporation, (2) the latest financial data available on insured institutions in liquidation, and (3) results of independent appraisals made by contract appraisers. As of December 31, 1973, the Corporation did not anticipate that any losses would be incurred on the loans to insured institutions. Any losses which might occur would be recognized when and if collection of the loans becomes doubtful.

The book value of assets acquired from insured institutions represents unpaid balances of mortgage loans at the time of acquisition, the acquisition cost of real estate and other assets, and capitalized expenditures--such as taxes and insurance--less amounts received on the principal of the loans. The net value of assets acquired at December 31, 1973, was $52 million.

The loans to insured institutions and accrued interest of $69 million consisted of interest-bearing loans of $67 million to associations that required financial assistance and accrued interest of $2 million.

Subrogated accounts of $65 million represent the rights of depositors acquired by the Corporation through payment to the depositors of their insured accounts. Thus the Corporation, in place of the original depositors, has acquired claims against the assets of the association.

RESERVES AND BORROWING AUTHORITY

The Corporation estimated that, at December 31, 1973, savings insured by it in 4,163 insured institutions totaled about $220.9 billion. The resources available to the Corporation at December 31, 1973, to meet demands which may be made upon it for discharge of its insurance liability are described below.

Cumulative net income of $2.1 billion from operations has been retained as a primary reserve pursuant to section 404(a) of the National Housing Act, as amended (12 U.S.C. 1727). The secondary reserve, amounting to $1.4 billion at December 31, 1973, consisted of (1) cumulative insurance premium prepayments of $1.3 billion assessed against insured institutions from fiscal year 1962 through calendar year 1973 and (2) cumulative interest of $582 million on the outstanding balance of the prepayments less cumulative transfers from the secondary reserve of $480 million for use as premium payments.

Public Law 93-100 (87 Stat. 346), approved August 16, 1973, discontinued all payments to the secondary reserve and granted the Corporation authority to regulate annual insurance premiums. When the reserves are within statutorily specified limits, the premiums are to be paid on a part cash, part secondary reserve charge basis, within a 30- to 70-percent range to be established by the Board. The Board is currently deducting 30 percent of premium insurance from the insured members' secondary reserve and collecting 70 percent in cash. The legislation did not, however, insure a complete phaseout of the reserve. Currently, the Board is working on an amendment specifically designed to insure a complete phaseout of the secondary reserve over a period of about 10 years.

The Corporation's primary and secondary reserves are available to meet future losses. These reserves, established pursuant to 12 U.S.C. 1727 and administrative action, do not represent a measure of the insurance risk which is imposed on the Corporation by pertinent legislation. In our opinion, the reserves were adequate to meet potential losses that might result from problem conditions known to exist in specific insured institutions at December 31, 1973, under existing economic conditions. The adequacy of the reserves, however, is directly affected by economic conditions. Whether these reserves would be adequate during periods of severely adverse economic conditions is currently not determinable.

The Corporation may draw on three other sources, in addition to its reserves, for insurance purposes. It may:

1. Require insured institutions to deposit with the Corporation up to 1 percent of their withdrawable deposits. The exercise of this authority as of December 31, 1973, would have provided funds of about $2.2 billion to the Corporation. 12 U.S.C. 1727(h).

2. Assess additional premiums against insured institutions equal to accumulated losses and expenses of the Corporation. Such assessments against an institution in any one year may not exceed one-eighth of 1 percent of the total amount of the insured members' accounts. 12 U.S.C. 1727(c).

3. Borrow up to $750 million from the U.S. Treasury. 12 U.S.C. 1725(i).

The Corporation had not drawn on any of these sources through calendar year 1973.

The insured institutions have their own reserves and surpluses available to meet losses. As of December 31, 1973, they had a total of about $16.5 billion in reserves and surpluses.

SCOPE OF EXAMINATION

Our examination of the Corporation consisted principally of a review of its statement of financial condition at December 31, 1973, and the related statements of income, expense, and primary reserve and of changes in financial position for calendar year 1973. Also, we reviewed the basic laws, rules, and regulations applicable to the Corporation to ascertain the policies and restrictions under which it is required to operate.

Our review of associations classified by the Board as problem cases and a sample of all other insured associations consisted of discussions with officials of the Board's Office of Examinations and Supervision and an examination of their reports and related records for these associations.

We made our examination in accordance with generally accepted auditing standards and included such tests of the accounting records and such other procedures as we considered necessary in view of the effectiveness of the system of internal control and the work performed by the Board's Office of Audits.

CHAPTER 5

OPINION ON FINANCIAL STATEMENTS

In our opinion, the accompanying financial statements (schs. 1 through 9) present fairly the financial position of the Board, banks, and Corporation at December 31, 1973, and the results of their operations and changes in financial positions for the year then ended, in conformity with the principles and standards of accounting prescribed by the Comptroller General of the United States.

FEDERAL HOME LOAN BANK BOARD

COMPARATIVE STATEMENT OF FINANCIAL CONDITION

AT DECEMBER 31, 1973 AND 1972

	December 31, 1973	December 31, 1972
ASSETS		
Cash with U.S. Treasury (note 2)	$ 346,230	$ 751,678
Accounts receivable	6,308,503	5,641,857
Inventory--supplies	36,167	18,999
Leasehold improvements (note 1)	84,995	206,305
Land and building (note 3)	10,207,445	3,540,652
Furniture, fixtures, and equipment, net (note 1)	949,999	1,032,628
Total assets	$17,933,339	$11,192,119
LIABILITIES AND CAPITAL		
Accounts payable and accrued liabilities	$ 3,042,672	$ 3,051,907
Liabilities for employees' accrued annual leave	1,611,538	1,498,994
Deferred credits (note 4)	1,080,000	-
Loans payable to Federal home loan banks	8,869,680	4,910,680
Total liabilities	14,603,890	9,461,581
Capital, retained earnings (sch. 2)	3,329,449	1,730,538
Total liabilities and capital	$17,933,339	$11,192,119

The notes following schedule 3 are an integral part of this statement.

SCHEDULE 2

FEDERAL HOME LOAN BANK BOARD

COMPARATIVE STATEMENT OF INCOME, EXPENSE, AND RETAINED EARNINGS FOR THE YEARS ENDED DECEMBER 31, 1973 AND 1972

	December 31, 1973	December 31, 1972
INCOME:		
Examination fees, examinations of savings and loan institutions	$12,340,516	$10,296,961
Assessments against:		
Federal home loan banks	6,170,170	5,842,941
Federal Savings and Loan Insurance Corporation	11,382,764	10,325,449
Reimbursements for services performed for other agencies	229,733	376,001
Leases--Federal Home Loan Bank Board property	5,206	12,062
Miscellaneous	22,984	15,595
Total income	30,151,373	26,869,009
EXPENSES:		
Personnel compensation	19,371,749	18,326,483
Personnel benefits	1,953,912	1,495,913
Travel and transportation of persons	2,713,750	2,605,328
Transportation of things	15,516	13,973
Rent, communications, and utilities	1,739,307	1,720,130
Printing and reproduction	429,827	307,500
Other services	1,267,321	1,381,411
Supplies and materials	200,600	271,204
Depreciation of furniture, fixtures, and equipment and acquisition of expendable property items	568,042	243,766
Interest on Federal home loan bank loans	292,438	232,461
Total expenses	28,552,462	26,598,169
INCOME IN EXCESS OF EXPENSES	1,598,911	270,840
RETAINED EARNINGS AT BEGINNING OF YEAR	1,730,538	1,459,698
RETAINED EARNINGS AT END OF YEAR (sch. 1)	$ 3,329,449	$ 1,730,538

FEDERAL HOME LOAN BANK BOARD

STATEMENT OF CHANGES IN FINANCIAL POSITION

YEAR ENDED DECEMBER 31, 1973

FUNDS PROVIDED BY:	
Net income	$1,598,911
Add noncash charges to income:	
Depreciation of furniture and equipment	395,328
Amortization of leasehold improvements	7,962
Total funds provided from operations	2,002,201
Realization on leasehold improvements	845
Loans from Federal home loan banks	4,200,000
Decrease in working capital	499,496
Decrease in cash	405,448
Total funds provided	$7,107,990
FUNDS APPLIED:	
Purchase of furniture and equipment	$ 312,699
Purchase of leasehold improvements	(112,502)
Acquisition of land and building	6,666,793
Repayment of loans to Federal home loan banks	241,000
Total funds applied	$7,107,990

FEDERAL HOME LOAN BANK BOARD

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1973

1. Significant accounting policies:

    --Furniture, fixtures, and equipment are depreciated over a 10-year period using the straight-line method.

    --Leasehold improvements are amortized on a straight-line basis with all improvements to be fully amortized by 1976.

2. An additional $11,105,356 is available in a separate fund provided by appropriation pursuant to the provisions of the Emergency Home Finance Act of 1970. Pub. L. No. 91-351, 84 Stat. 450. The funds are used for adjusting the effective interest the Federal home loan banks charged on short-term and long-term borrowing to promote an orderly flow of funds into residential construction.

3. Includes approximately $2.9 million which is the cost of the remaining portion of the original site for the new building.

4. Represents unearned assessments from savings and loan institutions.

FEDERAL HOME LOAN BANKS

COMBINED COMPARATIVE STATEMENT OF FINANCIAL CONDITION

AT DECEMBER 31, 1973 AND 1972

ASSETS

	December 31, 1973	December 31, 1972
CASH:		
On hand and in banks (note 6)	$ 123,112,568	$ 107,869,449
Treasury of the United States	33,547,153	21,055,754
Total cash	156,659,721	128,925,203
INVESTMENTS:		
Securities at cost which approximates market value	3,437,495,044	2,125,361,881
Stock in Federal Home Loan Mortgage Corporation (note 7)	100,000,000	100,000,000
Total investments	3,537,495,044	2,225,361,881
ADVANCES TO MEMBERS:		
Secured	14,549,790,101	7,271,177,896
Unsecured	597,353,489	707,410,179
Total advances	15,147,143,590	7,978,588,075
OTHER LOANS	947,613,534	314,653,951
ACCRUED INTEREST RECEIVABLE	99,450,144	56,867,363
DEFERRED CHARGES	18,325,916	11,032,154
BANKS PREMISES AND FURNISHINGS, net (note 1)	12,190,011	14,661,013
OTHER ASSETS	1,499,258	1,178,787
Total assets	$19,920,377,218	$10,731,268,427

The notes following schedule 6 are an integral part of this statement.

LIABILITIES AND CAPITAL

	December 31, 1973	December 31, 1972
DEPOSITS:		
Members:		
Time	$ 1,215,143,595	$ 999,235,229
Demand	528,636,973	548,067,842
Government instrumentalities--demand	202,943	619,119
Applicants for membership	517,975	272,950
Total deposits	1,744,501,486	1,548,195,140
ACCRUED INTEREST PAYABLE	285,979,293	123,296,078
ACCOUNTS PAYABLE	4,840,906	2,039,512
OTHER DEFERRED CREDITS	6,551,411	4,483,001
OTHER LIABILITIES	19,918,944	28,033,283
CONSOLIDATED OBLIGATIONS (notes 1 and 2)	15,362,280,000	6,970,665,000
Total liabilities	17,424,072,040	8,676,712,014
COMMITMENTS (note 5)		
CAPITAL STOCK $100 PAR VALUE (note 3):		
Total paid in on subscriptions	2,122,334,730	1,756,010,450
RETAINED EARNINGS:		
Legal reserve	244,071,521	208,405,550
Unreserved earnings	129,898,927	90,140,413
Total retained earnings	373,970,448	298,545,963
Total capital	2,496,305,178	2,054,556,413
Total liabilities and capital	$19,920,377,218	$10,731,268,427

SCHEDULE 5

FEDERAL HOME LOAN BANKS

COMBINED COMPARATIVE STATEMENT OF INCOME AND EXPENSE

FOR THE YEARS ENDED DECEMBER 31, 1973 AND 1972

	December 31, 1973	December 31, 1972
EARNED INCOME:		
Interest on advances	$ 814,083,851	$428,485,564
Interest on other loans	2,318,580	2,227,395
Interest on securities	193,299,143	149,969,064
Income from other services	8,892,928	3,052,482
Miscellaneous	2,323,935	2,893,777
Total income	1,020,918,437	586,628,282
COST AND EXPENSES:		
Interest and other financing costs:		
Interest and concessions for marketing consolidated obligations (note 2)	741,478,717	451,981,656
Paid through Office of Fiscal Agent	1,481,955	1,035,285
Interest on members' deposits	62,483,909	51,412,602
Other interest costs	-	95,032
Gain (-) or loss on sale of securities	3,073,405	-4,148,305
Total interest and other financing costs	808,517,986	500,376,270
Other costs and expenses:		
Employee compensation and benefit costs (note 4)	13,872,122	11,191,363
Travel	952,892	810,490
Other administrative expenses	18,006,267	14,329,233
Total other costs and expenses	32,831,281	26,331,086
Income (-) and expense adjustments--prior years	1,239,313	-116,323
Total other costs and expenses	842,588,580	526,591,033
NET INCOME	$ 178,329,857	$ 60,037,249

The notes following schedule 6 are an integral part of this statement.

SCHEDULE 6

F E D E R A L   H O M E   L O A N   B A N K S

COMBINED STATEMENT OF CHANGES IN FINANCIAL POSITION

YEAR ENDED DECEMBER 31, 1973

FUNDS PROVIDED:		
Repayment of advances made to members		$ 2,844,856,768
Investments redeemed or sold (at amortized cost)		86,483,735,546
Sale of consolidated obligations		10,600,000,000
Capital paid in by members		402,106,280
Payment on loan for office building, FHLBB		192,635
Reversals made to undivided profits		777,087
Purchase of construction of bank premises		1,237,843
Net changes in other assets and liabilities		277,813,494
Net increase in funds resulting from operations:		
Net income for the period ($178,329,856) and depreciation of bank premises and furnishings ($2,091,987)	$180,421,843	
Less amortization of premium and discount on investment securities, net	65,631,977	
Net increase		114,789,866
Total funds provided		$100,725,509,519
FUNDS APPLIED:		
Loans guaranteed by Agency for International Development, net		$ 15,952,218
Advances made to members		10,013,412,283
Purchase of investments		87,730,236,731
Redemption of consolidated obligations		2,208,385,000
Repurchase of capital stock		35,782,000
Purchase of furniture and equipment		858,828
Dividends declared on capital stock		101,242,958
Loans made to FHLMC		613,000,000
Savings Associations Retirement Fund		61,193
Legal fee (sale of Greensboro building)		500
Loan for office building, FHLBB		4,200,000
Supplemental annuities for retiring bank presidents		179,000
Six-year backfunding FICA		1,622,398
Retirement fund		141,001
Loss on sale of Greensboro building		435,409
Total funds applied		$100,725,509,519

FEDERAL HOME LOAN BANKS

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1973

1. Significant accounting policies:

--Investments are stated at cost, adjusted for amortization of premiums and discounts. Such amortization is computed generally on the straight-line method over the lives of the related securities.

--Furniture, fixtures, and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets and amortization over the terms of the respective leases.

--Concessions on Federal home loan bank consolidated obligations are amortized over the terms of the respective debt issued.

--The banks are required by statute to invest in capital stock of the Federal Home Loan Mortgage Corporation. Such investment is carried at the original cost of the shares acquired.

--The banks maintain a retirement plan for all eligible employees and follow the policy of accruing and funding current service costs and unfunded past service cost over approximately 10 years.

2. Consolidated Federal home loan bank obligations issued by the Federal Home Loan Bank Board and now outstanding are the joint and several obligations of all Federal home loan banks.

3. The capital stock of each Federal home loan bank may not be issued at a price below par value. Such stock is nonnegotiable and can be redeemed by the banks.

Retained earnings of the banks consist of undivided profits and a legal reserve. The banks must transfer 20 percent of its net income to the reserve semiannually until the reserve equals the capital stock amount. Subsequently, 5 percent of net income shall be added to the reserve.

4. The banks participate in the Savings Association Retirement Fund, and substantially all eligible employees are covered by the plan.

5. At December 31, 1973, the banks had commitments for advances to member associations and to foreign borrowers totaling about $1.9 billion and leases on office facilities.

6. At December 31, 1973, the following banks had cash deposited with commercial banks representing compensating balances in lieu of bank service charges.

Federal Home Loan Bank	Approximate balance
Boston	$ 300,000
Cincinnati	6,000,000
Indianapolis	4,500,000
Little Rock	1,000,000
New York	10,200,000

7. The Federal Home Loan Mortgage Corporation is wholly owned by the Federal home loan banks. At December 31, 1973, stock issued to the banks consisted of 100,000 shares with a par value of $1,000 per share.

SCHEDULE 7

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

COMPARATIVE STATEMENT OF FINANCIAL CONDITION

AT DECEMBER 31, 1973 AND 1972

	December 31, 1973	December 31, 1972
ASSETS		
CASH ON HAND AND WITH THE U.S. TREASURY	$ 250,628	$ 1,630,695
ACCOUNTS RECEIVABLE	9,027,891	935,452
INVESTMENTS AT AMORTIZED COST (notes 1 and 2)	3,229,625,339	2,874,994,705
ACCRUED INTEREST ON INVESTMENTS	55,460,415	44,003,636
ASSETS ACQUIRED FROM INSURED INSTITUTIONS (after allowance for losses) (note 5)	51,887,091	50,892,984
LOANS TO INSURED INSTITUTIONS AND ACCRUED INTEREST	69,372,337	75,548,439
SUBROGATED ACCOUNTS IN INSURED INSTITUTIONS IN LIQUIDATION (after allowance for losses)	64,606,454	138,105,531
INSURED ACCOUNTS IN INSURED INSTITUTIONS IN LIQUIDATION (pending and unclaimed accounts)	-	16,848
DEFERRED CHARGES AND OTHER ASSETS	47,348	96,552
Total assets	$3,480,277,503	$3,186,224,842
LIABILITIES AND RESERVES		
MISCELLANEOUS ACCRUED AND OTHER LIABILITIES	$ 4,019,881	$ 8,133,109
PENDING AND UNCLAIMED ACCOUNTS IN INSURED INSTITUTIONS	-	16,848
ALLOWANCE FOR ESTIMATED LOSSES--CONTRIBUTION AGREEMENTS	22,143,469	25,802,507
DEFERRED CREDITS	609,631	9,904,689
COMMITMENTS (note 4)		
PRIMARY RESERVE (cumulative net income) (sch. 8) (note 3)	2,076,342,741	1,758,444,827
SECONDARY RESERVE (premium prepayments) (note 3)	1,377,161,781	1,383,922,862
Total liabilities and reserves	$3,480,277,503	$3,186,224,842

The notes following schedule 9 are an integral part of this statement.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

COMPARATIVE STATEMENT OF INCOME, EXPENSE, AND PRIMARY RESERVE

FOR THE YEARS ENDED DECEMBER 31, 1973 AND 1972

	December 31, 1973	December 31, 1972
INCOME:		
Insurance premiums and admission fees (note 1)	$ 176,123,043	$ 153,504,294
Interest on U.S. and Federal agency securities	189,342,556	158,919,929
Interest on loans to insured institutions	12,576,736	6,600,927
Income on assets acquired from insured institutions	6,022,410	7,608,998
Interest income on advance contributions	322,875	-
Miscellaneous	90,955	108,674
Nonoperating	998,526	1,671,214
Total income	385,477,101	328,414,036
EXPENSES:		
Administrative expenses	538,264	504,976
Services rendered by Federal Home Loan Bank Board	10,503,058	11,685,259
Insurance settlement and other expenses	2,877,361	6,244,541
Unallocated nonadministrative expenses	1,829,796	-
Net provision for losses	1,410,230	1,178,153
Interest applicable to premium prepayments credited to members' equity in secondary reserve	81,786,604	79,270,053
Total expenses	98,945,313	98,882,982
Income before extraordinary item	286,531,788	229,531,054
Extraordinary item--Write off of allowance for losses on assets acquired (note 5)	31,366,126	-
Net income transferred to primary reserve	317,897,914	229,531,054
BALANCE, PRIMARY RESERVE, AT THE BEGINNING OF THE YEAR	1,758,444,827	1,528,913,773
BALANCE PRIMARY RESERVE, AT THE END OF YEAR (sch. 7)	$2,076,342,741	$1,758,444,827

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

STATEMENT OF CHANGES IN FINANCIAL POSITION

YEAR ENDED DECEMBER 31, 1973

FUNDS PROVIDED:	
Net income	$317,897,914
Add expenses not requiring outlay of working capital:	
Depreciation of furniture and equipment	4,715
Adjustment to provisions for losses on:	
Assets acquired from insured institutions	(31,366,126)
Estimated contributions to insured institutions	3,392,403
Loans sold under guaranty plan	(1,982,172)
Accrued return on secondary reserve	81,786,604
Transfers from secondary reserve to pay insurance premiums	(88,131,304)
Total funds resulting from operations	281,602,034
Realization on assets acquired from insured institutions:	
Principal payments on mortgage loans	13,980,852
Principal payments on contracts and other assets	2,028,039
Cash sales of real estate and other assets	16,045,360
Principal payments on loans to insured institutions	4,506,018
Liquidating dividends on subrogated accounts	73,502,285
Maturities of FNMA securities	1,600,000
Decrease in cash	1,380,067
Total funds provided	$394,645,155
FUNDS APPLIED:	
Acquisitions of assets:	
Acquisition of investment securities	$357,503,639
Assets purchased from insured institutions	269,444
Capitalized expenditures on assets purchased from insured institutions	1,413,289
Furniture and equipment	3,865
Payment of claims of insured accounts in insured institutions in liquidation	3,208
Contributions to insured institutions	7,051,441
Refund of secondary reserve premium to institutions canceling insurance	416,381
Increase in working capital	27,983,888
Total funds applied	$394,645,155

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1973

1. Significant accounting policies:

   --The Corporation depreciates its furniture, fixtures, and equipment over a 10-year period using the straight-line method.

   --Investments are shown on schedule 7 at amortized cost. Discounts and premiums are amortized over the term of the related securities.

   --Income from insurance premiums is recognized as earned when the associations are assessed.

2. The market value of investments at December 31, 1973, was $3,147,434,613.

3. The Corporation considers the primary and secondary reserves to be more than adequate to absorb the additional disbursements that it is estimated the Corporation might be required to make in discharging its insurance indemnity liability for insured institutions currently in financial difficulty.

4. The Corporation enters into contribution agreements with thrift institutions to restore them to normal operations. Under these arrangements the Corporation agrees to make, or commits itself to make, a cash contribution. As of December 31, 1973, these agreements totaled $196,497,000 of which $105,782,000 has not been recognized.

5. In 1971 the Corporation increased their Provisions for Losses on Assets Acquired by $35 million. The increase at that time was charged against current operating income. The $31 million credit to income during calendar year 1973 reflects a reevaluation of this increase by the Corporation.

PRINCIPAL OFFICIALS OF THE FEDERAL HOME LOAN BANK BOARD AND THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION RESPONSIBLE FOR THE ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
BOARD		
BOARD OF DIRECTORS:		
Thomas R. Bomar, Chairman	June 1973	June 1978
Grady Perry, Jr.	June 1973	June 1977
Garth Marston (note a)	Apr. 1974	June 1975
Carl O. Kamp, Jr.	May 1969	Aug. 1973
CORPORATION		
DIRECTOR:		
Richard Platt, Jr.	Sept. 1973	Present
Roger K. Lindland	Nov. 1971	Aug. 1973

[a] Filling the unexpired term of Mr. Kamp.

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