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REPORT BY THE

Comptroller General

OF THE UNITED STATES

The National Consumer Cooperative Bank: An Institution In Transition

The Bank was chartered in August 1978 to provide financial and technical assistance to cooperatives--enterprises collectively owned and operated for mutual benefit. However, it did not become operational until March 1980. GAO's review showed that the Bank has experienced much turmoil from major organizational changes, conversion from a mixed-ownership government corporation to a quasi-private institution, and high personnel turnover.

While GAO found that recent Bank actions should improve Bank operations, the organizational changes reduced regional resources and this may limit the Bank's ability to develop cooperatives nationwide. Before this action the Bank could not demonstrate an ability to develop the cooperatives needed to sustain itself over the long term. A judgment of the Bank's situation should be tempered by the fact that the Bank has been operating only 3 years and may not have had time to demonstrate the ability to develop the needed cooperative universe.

GAO also found that technical assistance and other cooperative development activities were deemphasized, contracting policies and procedures were not always followed, and questionable practices were associated with the process for electing nine Board members. On the positive side, GAO found that the Bank had improved shareholder and public communication efforts and had almost always consistently applied personnel policies.

GAO/RCED-84-75
DECEMBER 15, 1983

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

B-200951

The Honorable Fernand J. St Germain
Chairman, Committee on Banking, Finance
and Urban Affairs
House of Representatives

Dear Mr. Chairman:

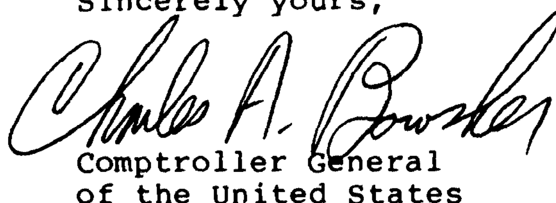
As requested in your March 15, 1982, letter and in subsequent meetings with your office, we reviewed certain areas of the operations of the National Consumer Cooperative Bank. As arranged with your office, we issued a letter report on December 16, 1982 (B-200951) which reported on the legality of a loan to the Dunbar No. 1 Cooperative Housing Corporation and the adequacy of the Bank's conflict-of-interest policy.

This report addresses the Bank's organizational and procedural changes over its brief history and their implications for its future. It discusses areas such as the election of the Bank's Board of Directors, communications, and personnel practices. It also discusses management weaknesses and other issues.

Because the Bank considers certain information to be confidential, we have prepared a supplement to this report which contains the confidential information. As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days from the date of the report. Also, as arranged with your office, at that time we will send copies of the report and supplement to the National Consumer Cooperative Bank and the Farm Credit Administration. We will not release the supplement to the public.

Upon release, we will send copies of the report to other interested parties and make copies available to others upon request.

Sincerely yours,



Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CHAIRMAN,
COMMITTEE ON BANKING,
FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

THE NATIONAL CONSUMER COOPERATIVE BANK: AN INSTITUTION IN TRANSITION

DIGEST

The National Consumer Cooperative Bank, chartered in August 1978 by the National Consumer Cooperative Bank Act, provides financial and technical assistance to cooperatives--enterprises collectively owned and operated for mutual benefit. The Bank began operating in March 1980. From the Bank's inception through December 31, 1981, the Congress appropriated $184.27 million to the Department of the Treasury for the purchase of Bank stock for financing Bank loans to cooperatives and appropriated $41.5 million to the Bank--$25.28 million for making high-risk loans and $16.22 million for administering loan and technical assistance programs.

On December 31, 1981, the Bank became a quasi-private institution--the $184.27 million appropriated for Bank stock was converted into long-term subordinated capital notes, and the Bank's federal appropriations were discontinued. As of March 31, 1983, the Bank had approved loans to 142 cooperatives totaling over $132 million.

The Chairman, House Committee on Banking, Finance and Urban Affairs, requested that GAO review the Bank's operations and organizational structure, concentrating on technical assistance and other cooperative development activities, regional operations, the 1982 Board of Directors election of nine members, the contracting process, communication efforts, and personnel matters. (See p. 1.)

In commenting on the report, the Bank said that some examples represent activities that took place nearly 4 years ago. To do the job the Chairman requested, GAO was required to review certain matters which occurred before the Bank became operational in March 1980 and, as such, the report discusses those matters.

Because the Bank considers certain information to be confidential, GAO prepared a supplement to this report which contains the confidential information.

GAO/RCED-84-75
DECEMBER 15, 1983

OBSERVATIONS ON THE BANK'S FUTURE

GAO believes that the Bank is at a crossroad in its development. During its short history, the Bank has undergone major organizational changes, converted from a mixed-ownership government corporation to a quasi-private institution, and experienced high personnel turnover. To carry out its title II activities, the Bank recently established a nonprofit corporation to administer financial and technical assistance primarily to new, emerging, or low-income cooperatives. Also, the Bank reorganized in April 1983 by unifying its lending process and restructuring regional operations. It is also implementing new contracting procedures.

Some recent Bank actions should improve Bank operations, but the action reducing the number of regional offices and staff may limit the Bank's ability to develop cooperatives nationwide. Even before this action, the Bank could not demonstrate that it could develop the cooperative community it needs to make enough financially sound loans to allow for portfolio growth of the size and quality needed to meet its long-term financial obligations.

This judgment of the Bank's situation, however, should be tempered by the fact that the Bank has been operating only about 3 years and may not have had the time to demonstrate the ability to develop the needed cooperative universe. Also, the Bank has had to adjust to the loss of federal financial support and to contend with much turmoil resulting from organizational changes. (See p. 88.)

In commenting on this report, the Bank said that only time will tell whether it can develop the number of cooperatives needed for making enough loans to meet its long-term financial obligations. The Bank disagreed with GAO's conclusion on the effect of the April reorganization on cooperative development. The Bank's comments and GAO's evaluation on this matter are presented below and on pages 33, 43, and 92.

TITLE II ACTIVITIES LOSE VISIBILITY

Title II of the act established a Self-Help Office within the Bank to make loans and administer developmental and outreach programs to new, emerging, and low-income cooperatives. Until December 1982 the Bank maintained a separate Self-Help Office, but that office had been completely restructured in June 1981 and most of

its functions were transferred to other Bank units. GAO found that during the June 1981 to December 1982 period, the Bank decreased the emphasis given to title II activities, such as technical assistance to nonborrowing cooperatives, training, and outreach.

In accordance with its charter as amended in August 1981, the Bank established the Consumer Cooperative Development Corporation in December 1982 to administer the title II activities. GAO believes that this separate corporation could restore cooperative developmental and outreach activities if it is able to secure sufficient funding from the Bank or other sources. (See p. 21.)

The Bank said that it can and will provide adequate support to the Corporation for title II activities. GAO questions the Bank's position in light of the Bank's actions curtailing title II activities. Moreover, as previously noted, the Bank cannot demonstrate the ability to develop the portfolio to the size and quality needed to meet its own long-term financial obligations. A detailed evaluation of Bank comments is presented on pages 33 and 34.

REGIONAL OPERATIONS CONTINUE TO EVOLVE

The regional offices' role has evolved since they opened and their responsibilities and authority have increased. GAO found during field visits that regional offices had limited resources for carrying out their responsibilities, such as being the primary contact with cooperatives; conducting business development activities; developing, analyzing, and managing loans; and providing technical assistance. For example, before its April 1983 reorganization, the Atlanta Regional Office had only two professionals to service 12 Southeastern States.

The April 1983 reorganization abolished three regional offices, downgraded the Atlanta and Dallas regional offices to branch offices, and abolished 23 of 51 regional positions. This will further limit the Bank's developmental capabilities. The Bank reorganized to cut expenses during a time it faces the difficult tasks of developing financially sound loans and providing technical assistance to and addressing developmental needs of cooperatives. (See p. 35.)

The Bank disagreed with GAO's conclusion that curtailing the regional system will limit

cooperative development efforts and said that GAO underestimated the effect of the Consumer Cooperative Development Corporation becoming operational. GAO does not agree that it underestimated the effect of the Corporation. GAO recognizes, however, that if the Corporation evolves into a successful undertaking, the potential adverse effect of decreasing regional operations could be substantially mitigated. However, GAO continues to be concerned about the Corporation's development because of the previously noted uncertainties associated with the Corporation's funding. In addition, as of August 1983, the Bank continued to perform all title II activities for the Corporation and no chief operating officer or other Corporation staff had been hired. A detailed evaluation of Bank comments is presented on page 43.

QUESTIONS CONCERNING THE ELECTION

GAO found that questionable practices were associated with the process for electing nine Board members in 1982. For example:

--The Bank established stricter eligibility requirements for purchasing voting stock after it announced the election. Because of that action, 66 applicants were denied the opportunity to become eligible shareholders and accordingly could not vote. Also the requirements were not consistently applied to all applicants. (See p. 49.)

--The Board decided to disqualify five ballots because an officer other than the secretary certified election documents. However, the election rules allow for other officers to certify if authorized by the cooperative. The Board disqualified these ballots without knowing with certainty whether the officers who had signed the documents were authorized to do so because, according to the Bank's former General Counsel, the Bank was under no obligation to inquire of the voters whether such authorization had been given. The Board's decision on these five ballots changed the election outcome.

GAO, with the concurrence of the Committee Chairman's office, did not ascertain whether these officers were authorized to sign the election documents because to do

so would have broken the pledge given to the shareholders by the Board that their ballots would remain secret. However, GAO observed that shareholders were not provided any form to document, nor were they told to document, that an official other than the secretary was authorized to certify election material. (See p. 57.)

--Someone opened five election envelopes before the official election date. There was no explanation as to who opened them or the circumstances leading to their premature opening. A sealed envelope was a shareholder's only safeguard that the completed ballot was the one used in the tally. Once opened, a ballot could have been replaced undetected because the official ballot contained no identifying marks. GAO does not know why the envelopes were opened or whether the ballots were altered. Accordingly, the impact of this occurence on the election outcome is uncertain. (See p. 59.)

In response to allegations of improprieties, the Board reviewed the election process and reported to shareholders in May 1982 that the election was handled with integrity and in full accordance with election rules. GAO found that the report contained inaccurate or misleading statements. For example, the Board said that no official election envelopes were opened prematurely, but GAO found that five ballots had been so opened. (See p. 60.)

GAO believes that the Bank needs to reevaluate the 1982 election process and the ramifications of the Board's decisions and decide what action, if any, it should take. However, the Bank's comments on this report challenged virtually every one of the deficiencies GAO noted. After evaluating these comments, GAO's position remains unchanged. (See pp. 62 to 66.)

The Bank agreed with GAO on the need to improve the process for future elections. The Bank said that because of the Board's concern that the next election avoid any questions it intended to issue new election procedures. (See p. 62.)

CONTRACTING PROCEDURES NOT FOLLOWED

Bank officials have not consistently followed established contracting policies and procedures. Contrary to its stated policy and procedures, the Bank awarded most of its goods and services

contracts sole-source without written justification. The Bank often did not prepare required procurement requests on time and allowed contractors to begin work before the Bank officially approved the contracts. Also, the Bank did not always comply with requirements for modifying and evaluating contracts. (See p. 67.)

The Bank recently adopted a new procurement manual which, if properly implemented, could correct many of the contracting weaknesses GAO identified. However, to further ensure the integrity of the contracting process the Bank needs to

--establish written requirements for including desired general terms in contracts and getting the contractor's signature on the official contract;

--require, when applicable, the contractor to certify that no organizational conflict of interest exists between it and the contract recipients; and

--require the next higher management level to approve all noncompetitive procurements made without written justification.

The Bank agreed to take action on all but the last GAO suggestion. The Bank said that its procedures require written justification in every procurement, except those exempted by the procurement policies. The exempted procurements--purchases of professional and consulting services up to $2,500 by department heads and up to $5,000 by division heads and above--are the ones GAO believes should be approved by the next management level. A detailed evaluation of Bank comments is presented on pages 76 and 77.

COMMUNICATION METHODS IMPROVED

GAO found that the Bank Board and management have taken, or were taking, actions to increase the flow of information to, and feedback from, member cooperatives and the public. The Bank uses public hearings, annual meetings, newsletters, and other mailings to communicate its activities. (See p. 78.)

The Bank agreed with GAO's conclusion that it has taken or is taking actions to improve member and public relations.

PERSONNEL POLICIES REVIEWED WERE CONSISTENTLY APPLIED

GAO's review of selected Bank personnel policies showed that the Bank had consistently applied these policies to the majority of employee records reviewed. For example, severance pay policies were consistently applied to employees involuntarily separated from the Bank. Allegations, however, have been made by employees separated from the Bank that they were treated unfairly. The Bank's practices of frequently changing its policies and of implementing policies before they are published may have contributed to this perception. (See p. 82.)

The Bank stated that it appreciated GAO's recognition that the personnel policies reviewed were consistently applied. A detailed evaluation of Bank comments is presented on page 87.

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ABBREVIATIONS

CCDC Consumer Cooperative Development Corporation

FCA Farm Credit Administration

GAO General Accounting Office

NCCB National Consumer Cooperative Bank

PMM Peat, Marwick, Mitchell, & Co.

RIF reduction-in-force

CHAPTER 1

INTRODUCTION

The National Consumer Cooperative Bank provides financial and technical assistance services to consumer, housing, and producer cooperatives. The Bank was chartered on August 20, 1978, by the National Consumer Cooperative Bank Act (12 U.S.C. 3001 et seq.). Before its April 1983 reorganization, the Bank had eight regional offices,[1] a headquarters in Washington, D.C., and a staff of about 130. As of March 31, 1983, the Bank approved over $132 million in loans to 142 cooperatives.

In response to a March 15, 1982, letter from the Chairman, House Committee on Banking, Finance and Urban Affairs, and several subsequent meetings with the Committee's Office, we reviewed the following areas at the Bank:

--The basis for the Bank's organizational structure and plans to change it.

--The emphasis the Bank has devoted to nonloan activities authorized in title II of the act, including services to cooperatives with predominantly low-income members.

--The operation of the Bank's regional office system.

--Certain aspects of the January 1982 election of members to the Board of Directors, including procedures for nominating candidates, determining voter eligibility, and counting votes.

--The contracting process, including an audit of a random sample of contracts to determine whether the Bank followed its contracting policies and procedures.

--Communication between the Bank and its member shareholders and the public.

--Application of Bank personnel policies.

--The legality of a $5.2-million loan to the Dunbar No. 1 Cooperative Housing Corporation and certain other related questions.

--Conflict-of-interest policies, including an evaluation as to whether they meet the act's requirements.

At the Chairman's request, we testified on May 24, 1983, before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance, House Committee on Banking, Finance and Urban Affairs, on the preliminary results of our review. In

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[1]Regional offices were located in Atlanta, Boston, Dallas, Detroit, Minneapolis, New York City, Oakland, and Seattle.

addition, as requested by the Chairman, we reported separately on the legality of the Dunbar loan in a December 16, 1982, letter (B-200951). Also, we included in that report the results of our evaluation of the Bank's conflict-of-interest policies. We determined that (1) the Dunbar cooperative was an eligible cooperative, (2) a Bank Board member and two employees violated the Bank's conflict-of-interest rules during the application, approval, or closure proceedings of the Dunbar loan, and (3) the conflict-of-interest policies met the act's requirement that they be no less stringent than standards set forth in Executive Order 11222.

The Chairman also requested that we evaluate the soundness of the Bank's loan portfolio. However, on April 28, 1982, the Board's Audit Committee requested that the Farm Credit Administration (FCA) also examine the Bank's loan portfolio. The Bank act, as amended, authorizes and directs both FCA and us to "examine and audit" the Bank. To prevent duplicative or unnecessary work, the Chairman agreed to defer this portion of the audit to FCA with the assurance that FCA would make this information available to us during our review.

WHY THE BANK?

The Bank act is based on the belief that by combining federal seed money with local initiative and citizen participation, consumer and other types of self-help cooperatives can be important economic mechanisms in both rural and urban communities. In developing the Bank's legislation, the Congress found that user-owned cooperatives were a proven method for increasing competition, broadening ownership and control of economic organizations, raising the quality of goods and services, and contributing to an improved standard of living for cooperative members and patrons. The Congress also found that consumer and other types of self-help cooperatives were being hampered in their formation and growth by the lack of access to adequate cooperative credit facilities and lack of technical assistance.

To alleviate these problems, the Congress passed legislation to provide financial and technical assistance to consumer cooperatives, much as the Small Business Administration does for small businesses. The legislation (1) established the Bank to make loans at market interest rates to consumer, housing, and producer cooperatives and also (2) created a Self-Help Development Fund and a technical assistance capability to assist new, small, and inner-city cooperatives.

PROVISIONS OF THE BANK ACT

The act, which was enacted on August 20, 1978, and amended on December 16, 1979, and August 13, 1981, is divided into two titles. Title I, which created and chartered the Bank, mandated the Bank to do such things as

- --encourage the development of new and existing cooperatives eligible for its assistance by providing specialized credit and technical assistance;

--maintain broad-based control of the Bank by its voting stockholders;

--encourage broad-based ownership, control, and active participation by members in eligible cooperatives; and

--assist in improving the quality and availability of goods and services to consumers.

Title I authorizes the Bank to extend credit to any organization determined by the Bank to be eligible, if the Bank also determines that the applicant has or will have (1) a sound organizational and financial structure, (2) income exceeding its operating costs and assets exceeding its obligations, and (3) a reasonable expectation of a continuing demand for its production, goods, commodities, services, or the use of its facilities, so that the loan will be fully repayable in accordance with its terms and conditions.

In the original act, title II established an Office of Self-Help Development and Technical Assistance within the Bank. The Self-Help Office was authorized to make a capital investment advance (hereafter called loan) to any eligible cooperative, either with or without a title I loan, if the Self-Help Office determined that (1) the applicant was not able to obtain required capital through a title I loan or from other sources, or (2) applicant membership is or will consist substantially of low-income persons, or the applicant proposes to provide specialized goods, services, or facilities to serve their needs, and (3) the applicant cannot obtain sufficient funds through a title I loan or otherwise, and the applicant presents a plan which the Self-Help Office determines will permit replacement of the capital investment loan out of member equities within a period not to exceed 30 years. The Self-Help Office was also authorized to make interest supplement loans to pay all or part of the interest payable to the Bank or other lenders by an eligible cooperative which could not pay the market interest rate because the cooperative sold goods to or provided facilities for the use of low-income persons.

Additionally, title II required and/or authorized the Self-Help Office to provide outreach such as organizational assistance, investigations of new types of services for cooperatives, financial analysis and market surveys, training and assistance to cooperative directors and management, and coordination with federal programs offering assistance to cooperatives.

The August 13, 1981, amendments made substantial changes in the Bank effective December 31, 1981. One change required the Bank's Board of Directors to establish a nonprofit corporation to perform the functions provided for under title II. On December 30, 1982, the Board established this nonprofit corporation and named it the Consumer Cooperative Development Corporation (CCDC).

Also, the 1981 amendments converted the Bank from an mixed-ownership government corporation to a quasi-private corporation,[2] and transferred control of the Bank from the federal government to its shareholders by authorizing shareholders to elect 12 of the 15 Board members with the President of the United States authorized to appoint the other 3 members. Previously, the President was authorized to appoint 12 of the 15 members.[3] In addition, the amendments converted class A stock (see below) and the remainder of the federal government's capital commitment into long-term subordinated capital notes. Finally, the amendments discontinued federal appropriations for the Bank's program administration.

In addition to class A stock, the act, as amended, authorized the Bank to issue other classes of stock. Class B, a voting stock, is issued to borrowers of the Bank, who are required to own class B stock in an amount not less than 1 percent of the face amount of the loan. Class C, also a voting stock, is issued to borrowers or cooperatives that are eligible to borrow from the Bank. Nonvoting stock may be issued at the discretion of the Board to other investors.

HISTORY OF FEDERAL APPROPRIATIONS

The Bank as initially established received federal funding through appropriations to the Department of the Treasury for its use to purchase class A stock from the Bank, the proceeds of which were to be used by the Bank to finance title I loans. The Bank also received direct appropriations to the Self-Help Office to finance capital investment and interest supplement loans and direct appropriations to the Bank and Self-Help Office for administration of titles I and II. From its inception through December 31, 1981, the Bank's net appropriations totaled $184.27 million for title I loans, $25.28 million for title II loans, and $16.22 million for program administration.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective in this review was to address each of the concerns of the Chairman of the House Committee on Banking, Finance and Urban Affairs as discussed in his March 15, 1982, letter or in subsequent meetings with the Chairman's office (see p. 1). We conducted our review at the Bank's Washington, D.C., headquarters and at four of its eight regional offices. We reviewed pertinent legislation and legislative history; Bank

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[2]The Bank is neither wholly public nor wholly private. The Bank is a congressionally chartered corporation with a government financial interest. By law the Bank is also subject to congressional oversight and examination and audit by GAO and FCA.

[3]Initially, the act provided that the President of the United States appoint all members with the advice and consent of the Senate. The act, as amended, provided that when the sale of class B and class C stock equaled $3 million, the Bank shareholders would elect 3 of the 15 authorized members.

regulations, procedures, and policies; and documents and reports prepared by the Bank, consultants, and others. We attended meetings of the Bank's Board of Directors and selected Bank Board committees, meetings of the Consumer Cooperative Development Corporation Board and its Executive Committee, and public comment sessions conducted by the Bank Board of Directors.

We also interviewed members of the Board of Directors and current and former employees. We conducted our review during the 1-year period March 1982 to March 1983, except as otherwise noted. Our work was performed in accordance with generally accepted government auditing standards. More detailed information on each area reviewed is contained in appendix II.

In commenting on the report, the Bank said that some examples represent activities that took place nearly 4 years ago. To do the job the Chairman requested, we were required to review certain matters which occurred before the Bank became operational in March 1980 and, as such, the report discusses those matters.

CHAPTER 2

THE NATIONAL CONSUMER COOPERATIVE BANK--

AN OVERVIEW

The Bank was chartered on August 20, 1978, but it did not begin operating until March 21, 1980. Subsequent to signing the Bank act, the Carter administration established, in September 1978, an interagency task force to prepare recommendations for operating the Bank including the Self-Help Office and began a search for the Bank's Board of Directors and a Director for the Self-Help Office. The task force made its report in July 1979, and the White House sent 13 Board appointees (increased to 15 in December 1979) for Senate confirmation. After confirmation, Board members were sworn into office during their first Board meeting in September 1979. Of the other two White House appointees, one was sworn into office in June 1980, and the other in July 1980.

During its first meeting, the Board adopted the bylaws and interim procurement and personnel policies for the Bank. Also, it authorized the creation of an ad hoc Presidential Search Committee. During October and November 1979, the Board created the following committees to manage the Bank's operations: (1) Personnel and Management, (2) Selp-Help, (3) Credit and Lending, and (4) Audit.[1] Also, during its November 1979 meeting, the Board confirmed that its Self-Help Committee had the authority to guide and monitor the title II program and to review and recommend policies and procedures for the Selp-Help Office. In December 1979, the Board adopted conflict-of-interest rules, an interest-rate policy, and a low-income definition policy. It also released draft title II regulations for public comment.

In January 1980 the Board selected the Bank's President and Chief Executive Officer and in March 1980 hired a Vice President for Management. The Board approved the first title I loans in April 1980. At that time, the Bank had a permanent staff of 59 employees, and some key positions were vacant. For example, the Bank did not hire a Vice President for Loan and Investment (title later changed to Vice President for Credit and Lending) until May 1980 and a Director of Community Affairs until June 1980. A Director for the Selp-Help Office, who in accordance with the act was to be appointed by the President of the United States, was not appointed until September 1980. He was sworn into office in October 1980, over 2 years after the act was signed.

In July 1980, before the Self-Help Director was appointed, the Board authorized the Bank's Low-Income Program Coordinator to perform the Director's duties. In August 1980 the Board published the title II policies in the Federal Register and approved the first title II loans.

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[1]The Board's standing committees as of April 1983, were credit and Lending, Finance, Audit, and Development and Marketing (hereafter referred to as Marketing).

In October 1980 the Bank opened the first of its regional offices in Oakland, California. It opened its eighth regional office in February 1981. All regions were fully staffed by June 1981.

On February 13, 1981, only 10 months after the Bank made its first loan and before all its regional offices were fully operational, the Reagan administration advised the Bank that it would be abolished and initiated action to rescind a portion of the Bank's appropriations. As of February 1981, the Bank had committed $75.6 million and $7.2 million in title I and II loans, respectively. At that time, the Bank's net appropriations totaled $137.3 million and $37.3 million, respectively, for such loans. Also, around that same time, the Director of the Self-Help Office stopped performing his duties but did not resign his position. In June 1981 the Bank established a Self-Help Coordinator position responsible for title II nonlending activities. About the same time, the Bank's employees were attempting to unionize and Bank management was studying ways to reorganize the Bank.

In June 1981 the Bank announced the first major organizational changes, which, among other things, essentially eliminated the Self-Help Office. The Congress opposed the administration's move to abolish the Bank. Subsequently, a compromise was reached and the Bank's charter was amended in August 1981, converting the Bank to a quasi-private institution and directing the Bank Board to establish a nonprofit corporation for performing title II activities. These two occurrences, along with a large turnover of personnel, have had major repercussions on the Bank. While the consequences cannot be precisely measured, they are reflected in a relatively poor quality loan portfolio, negative publicity and charges of wrongdoings, and a disillusioned cooperative community.

ORGANIZATIONAL CHANGES

The Bank's first organization provided for an Office of Self-Help Development and Technical Assistance and assigned that office responsibility for making loans provided for under its title II authority and for carrying out the Bank's technical assistance. This organizational structure was patterned after the Bank's legislative charter. (See p. 12.)

The Bank completely restructured the Self-Help Office, however, in June 1981, or about 14 months after the Bank had made its first loan. Among other things, the Bank abolished its Washington-based technical assistance unit and transferred responsibility for that work to its eight regional offices and other headquarters units. Also, it consolidated the title II lending activities with title I lending activities under the Bank's Vice President for Credit and Lending. The Bank left in place a Self-Help Office, but it was staffed with only one employee to advise on matters such as portfolio planning and the distribution and effectiveness of technical assistance funds.

Bank officials told us that these changes were made to improve the Bank (see chs. 3 and 4). Critics contend that the

Bank made the organizational changes to reduce its commitment to title II activities and to stonewall employee efforts to unionize. A more detailed discussion on what critics have said about the Bank and its management follows.

BANK'S POSITION CHANGED QUICKLY AND SUBSTANTIALLY

The Reagan administration's move to abolish the Bank and the quick and substantial changes made by the Congress have had major repercussions. For example, the administration's initial announcement and the Bank's countermoves to save its existence caused great turmoil within the Bank and diverted senior management attention away from the Bank's primary missions. Bank management reported to the Board of Directors in February 1982 that prior to July 1981, the Bank's future was so uncertain and the pressure was so constant that management had literally no time to plan for the Bank's future.

Moveover, one Bank board member said that the Bank made large title I loans, primarily to get control of federal dollars through the sale of class A stock to the Treasury. Such actions could have resulted in bad credit decisions. Although we observed that during the 5-month period ending June 30, 1981, the Bank made some of its largest title I loan commitments, we cannot say that the Bank would not have made these loans if it had not been for the administration's attempt to abolish the Bank. Also, we cannot say whether this policy contributed to the poor quality of the Bank's portfolio as discussed later in this chapter. Further, to compensate for the loss of federal appropriations, the Bank has redirected, reduced, and eliminated some of the title II nonloan activities and reduced staffing (see ch. 4).

HIGH PERSONNEL TURNOVER

The Bank has experienced a relatively high turnover in its personnel. Many of these employees were in key positions. From the date of its first employee separation in July 1980 through August 1982 (our cut-off date for this portion of our review), the Bank (which has never had more than 168 employees) lost 124 employees. This number represents an average annual turnover rate of about 35 percent. Of the 124 employees

--69, or about 56 percent, resigned;

--41, or about 33 percent, had their jobs abolished or were involved in reduction-in-force actions; and

--14, or about 11 percent, were fired.

Although the impacts, benefits and/or costs, of these separations are not readily apparent, the Bank's Executive Vice President said that the June 1981 reorganization had adversely impacted employee morale and the Bank's image, and the Bank is still suffering the consequences. He stated, however, that the

changes were sound and prudent actions and have improved the Bank's overall operations.

Although not as visible, but perhaps even more disruptive to the Bank than the June 1981 reorganization, is the loss of key employees through resignation. As noted above, 69 employees resigned during a 25-month period ending August 31, 1982. A number of those employees were in key positions. For example, during a 10-month period ending October 31, 1981, the Bank's Credit and Lending Division lost through resignations two vice presidents, one assistant vice president, one senior loan officer, and three loan officers.

POOR QUALITY LOAN PORTFOLIO

Under the authority of section 115 of the National Consumer Cooperative Bank Act, as amended (12 U.S.C. 3025), and in response to a request from the Bank Board's Audit Committee, FCA examined the quality of the Bank's titles I and II portfolios as of May 21, 1982. According to FCA's classifications, high-risk loans are (1) loans that are still considered collectible but involve probability of loss in the event repayment from available sources does not materialize and (2) loans of which all or any portion is deemed uncollectible. The other FCA classification for adverse loans is for loans which have serious credit weaknesses requiring more than normal servicing but which are believed to be fully collectible.

FCA's October 1982 report stated that,

> "Although the poor quality of the Bank's loan portfolio may have resulted partly from a business and lending philosophy deliberately formed with a greater tolerance for risk than was acceptable to conventional lenders, the causes more easily discerned by the examiners were deficiencies in organization and in capabilities and performance of its credit staff."

Information from FCA's October 1982 report that the Bank considers confidential is contained in attachment I of a supplement to this report which we will not release to the public.

NEGATIVE PUBLICITY AND CHARGES OF WRONGDOINGS

A vocal faction has formed within the cooperative community to support and promote the Bank's title II activities, contributing to a split within and outside the Bank. Philosophical differences have developed as to how the Bank should carry out its activities.

Persons from within that faction, both employees and outsiders, have reacted negatively to the Bank's management and charged it with certain wrongdoings as depicted in articles published during the period from October 1981 to June 1982 in

(1) Moving Food, a trade journal of the cooperating food distribution system, (2) The Village Voice, a New York City weekly newspaper, (3) The Co-op Bank Monitor, a national newsletter of the Co-op Development and Assistance Project,[2] and (4) NCCB Union News, an employee newsletter of the Bank's union organization committee. Among other things, the Bank's management has been charged with manipulating the process for electing members of the Board of Directors from start to finish, stonewalling employee efforts to unionize, and abolishing jobs and terminating employees under the pretext of reorganizations.

We considered these allegations as well as other oral allegations provided to us or to the Chairman's office in connection with our review of the areas requested by the committee. We found that some of the charges were valid but, for a large part, our work did not substantiate the allegations. Our findings are discussed in the other chapters of this report.

DISILLUSIONED COOPERATIVE COMMUNITY

The cooperative community has expressed its disillusionment with the Bank through several forms. In addition to airing their views in publications such as Moving Food and The Co-op Monitor, Bank shareholders signed a resolution calling for amending the Bank's bylaws to require shareholder approval of any bylaw adoption, amendment, or abolishment. This resolution, signed by 71, or about one-third of the Bank's shareholders, was presented to the Board in June 1982. In their letter asking other shareholders to sign the resolution, the six initiating shareholders said that the action was a first step in changing the Bank's current direction. They said that the Bank had failed to institute methods to ensure shareholder participation in the development of proposed policies that shape the Bank's structure.

Moreover, several shareholder representatives voiced their disillusionment with the Bank during the discussion period at the annual meeting in June 1982. A representative from a small food cooperative said that the cooperative thought the Bank was going to be a great resource, but the cooperative has been extremely disappointed. Another representative said that communication lines between the shareholders and the Board need to be opened. A third representative said that most shareholders are unclear on the differences in eligibility for titles I and II loans.

BANK COMMENTS AND OUR EVALUATION

The Bank said that it agreed with us as to the significant impact of the federal government's withdrawal of funds from the Bank. To a large extent, the Bank attributed its high staff turnover to a 1981 rescission proposal of the Reagan administration

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[2]An organization established in October 1979 to monitor the policies and operations of the Bank, particularly as they affect low-income, neighborhood, and community groups.

and the subsequent termination of the Bank's federal appropriations.

We recognize that the administration's move to abolish the Bank and the resulting changes, such as converting the Bank to a quasi-private institution, discontinuing its federal appropriations, and converting its class A stock held by the Department of the Treasury to class A capital notes, have affected the Bank's performance to date and its organizational and operational decisions. However, we did not assess the impact of the withdrawal of federal funds from the Bank as the Bank inferred. Concerning this matter, we observed that the federal government's withdrawal of appropriated funds appeared to have had no adverse impact on funds available to the Bank for administration. Our observaton is based on the fact that the Bank's 1982 income from operations and investments, less interest expense on government borrowings, was about $1.1 million, or about 5 percent greater than its 1981 income from operations and investments plus the 1981 federal appropriations for salaries and expenses.

CHAPTER 3

BANK'S ORGANIZATIONAL STRUCTURE IS STILL DEVELOPING

The Bank's organization has changed dramatically during its short 3-year history, and the need for further changes was addressed recently by Peat, Marwick, Mitchell & Co. (PMM), a management consulting firm hired by the Bank to study its organization and management, and by FCA, as part of its examination of the quality of the Bank's outstanding loans as of May 21, 1982. In response to PMM and/or FCA's work, the Bank has taken steps to improve its lending process and to develop a management information system. As of May 24, 1983, the Bank had tabled other organizational recommendations until it hired a new President.[1]

As agreed to in discussions with the Chairman's office, our review concentrated on the Bank's organizational structure and on the status of Bank action on recommended changes to this structure contained in PMM's June 1982 report. It was also agreed that work on the prior organizational structure and resulting changes would be limited to that necessary to understand the current structure.

In evaluating the Bank's organizational changes, two factors must be considered. The Bank is a relatively new organization and a certain amount of change is inevitable and even desirable. Second, the Bank has been subjected to an unusual number of external influences, including a threat to its existence and a reduction in Bank resources, that have made a number of organizational changes necessary.

EVOLUTION OF THE BANK'S ORGANIZATIONAL STRUCTURE

The Bank's first organization separated the title I and title II functions as provided by its chartering legislation. The Bank's organizational chart dated June 1980, which the former President told us was based extensively on the work of a consultant with some adjustments by the Vice President for Management, is presented on the next page.

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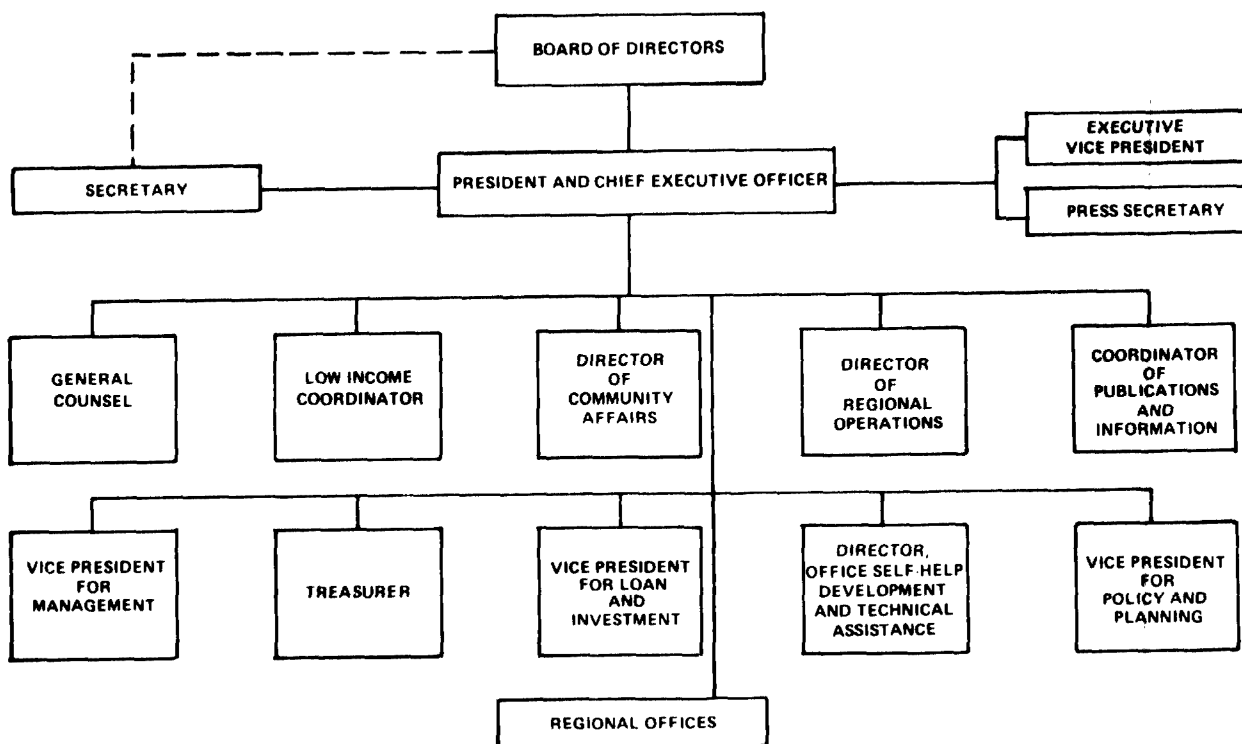
[1]From November 1, 1982, to June 5, 1983, the Bank's Executive Vice President operated as the Chief Executive Officer. The Bank Board gave the former President a 3-month sabbatical beginning November 1, 1982. Subsequently, the Board's Chairman announced that the former President would not return to the Bank at the end of the sabbatical. The Board appointed a new President and Chief Executive Officer who took office on June 6, 1983.



The Bank could not provide us with written documentation supporting the basis for the first organizational structure and the duties and responsibilities of the organizational units.

Through extensive interviewing of current and former Bank officials and the use of unapproved functional statements prepared by the Bank's former Vice President for Management, we pieced together the following functional statements for key Bank offices.

--The Office of Self-Help Development and Technical Assistance was responsible for carrying out the program of financial and technical assistance authorized by title II of the act. Within this office were three sub-units--housing, the self-help fund, and technical assistance. The housing unit was responsible for making title II real estate loans and providing technical assistance to housing cooperatives; the self-help fund unit was responsible for making title II nonhousing loans; and the technical assistance unit was responsible for providing technical assistance to all cooperatives other than housing.

--The Office of Loan and Investment was responsible for presenting recommendations for action on loan applications under title I of the act to Credit and

Lending Committee. Separate subunits were responsible for housing loans, commercial loans, loan servicing, and program development.

--The Office of Management was responsible for administering the Bank's specialized management services, including audit, personnel and training, accounting, budget, and procurement.

--The Office for Policy and Planning was responsible for advising the President and the Board on the design, development, and evaluation of Bank policies, plans, and programs. This office included the Strategic Planning Division which was to identify opportunities for cooperatives' development, including expansion into new markets. Other subunits within this office included marketing, intergovernmental affairs, and congressional affairs.

The Bank made its first organizational changes in late 1980. The change involved upgrading the Director of Regional Operations to a Vice President, in-line over the regional office directors who would report to the new Vice President rather than to the President.[2] The Bank's former President and its Executive Vice President both told us that this change was made to reduce the President's direct responsibility. Too many people, they said, were reporting directly to the President. In reporting this change to the employees, the President noted that it would not significantly change the day-to-day operations of the Bank. The organizational chart published by the Bank in December 1980 that reflects this change also showed the Executive Vice President in line directly under the President rather than as a separate office reporting to President. In discussing this change with the Bank's former President, we were told that the chart was prepared incorrectly. She said that even though the Executive Vice President was shown in a line position, the heads of the Bank's major offices continued to report directly to her rather than through the Executive Vice President. She also said that "the functions of the Executive Vice President were whatever the President wanted him to do." She agreed that the misdrawing of the organizational chart caused much confusion, but both she and the Executive Vice President told us that they understood the role of that office.

The Bank underwent a major reorganization in June 1981. Among other changes, the Bank

--consolidated title I and II lending activities under the Vice President for Credit and Lending;

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[2]We discuss the organization and operations of the regional offices in chapter 5.

--abolished the headquarters-based technical assistance unit and transferred responsibility for that work to its eight regional offices and other headquarters units;

--created a new Department of Development, (later called the Marketing Division) which consolidated the Divisions of Community Affairs, Co-op Development, Public Information, and Market Research and Development.

Although the Bank did not technically abolish the Office of Self-Help Development and Technical Assistance, it did so operationally. After the changes, the office was staffed with only one employee to advise on matters such as portfolio planning for the self-help fund and the distribution and effectiveness of technical assistance funds. A more detailed discussion of the title II activities is in chapter 4.

The June 1981 reorganization was based on recommendations of a special task force chaired by the Bank's Executive Vice President. In announcing the task force on March 16, 1981, the former Bank President said that the structure of the Bank's developmental activities needed to be reevaluated. She told us, however, that the underlying reason for the task force was that she was very dissatisfied with the way the title II program was being operated both in terms of credit decisions made and technical assistance given. She said that she wanted the Bank staff to "buy into" a reorganization rather than have her dictate what the organization would be.

The organizational problems that the Bank was experiencing were discussed in a March 19, 1981, memorandum from the task force chairman to the Bank's senior staff and included the following.

--Coordinating individual commercial projects between various divisions was time-consuming. No one person had the authority to set deadlines and, as a result, Bank customers were not timely serviced.

--Overlapping responsibilities between certain divisions resulted in duplication on the one hand and failure to perform tasks on the other.

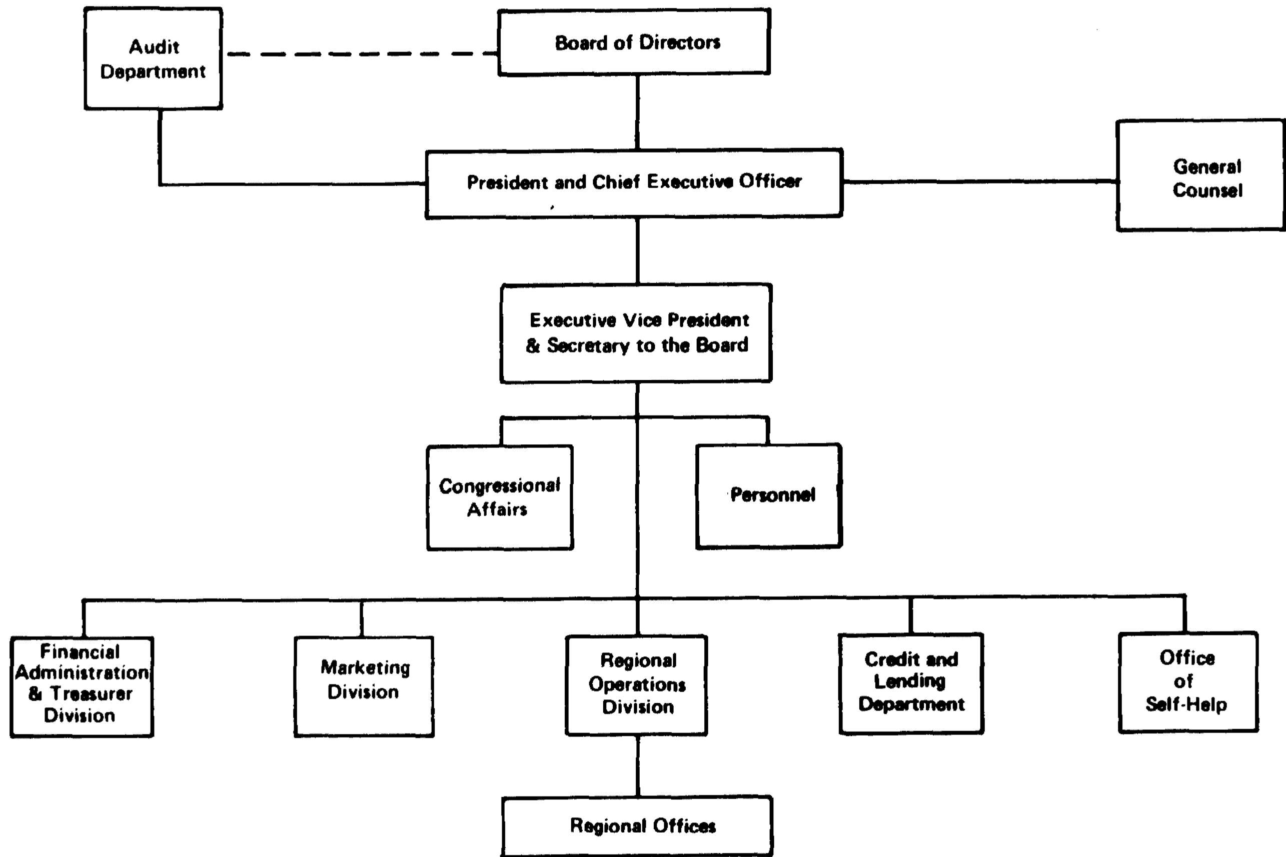
--Demand for title II loans and technical assistance was less than anticipated.

--The Bank's organizational structure which assumed a staff of 250 to 300 employees that would permit industry specialization throughout the Bank, especially within the Office of Self-Help Development and Technical Assistance and the Office of Policy and Planning, cannot be assured.

The task force chairman also noted that the timing of the reorganization was appropriate because there were several vacancies in top management positions and the regional office system was then in operation so it would be able to assume more responsibilities.

Other than stating what the problems were, the task force had little documentation supporting the problems and how they would be resolved by the organizational changes. The former Bank President told us that these changes were not communicated to the Board until after the decisions had been made because it was not appropriate to involve the Board. In this regard, the Bank's bylaws authorize the President to make organizational changes.

As the Bank was unable to furnish us an organizational chart reflecting the June 1981 reorganization, we developed such a chart using a March 1982 organizational chart and modifying it to represent the structure described in the Bank's announcement of the June 1981 reorganization.



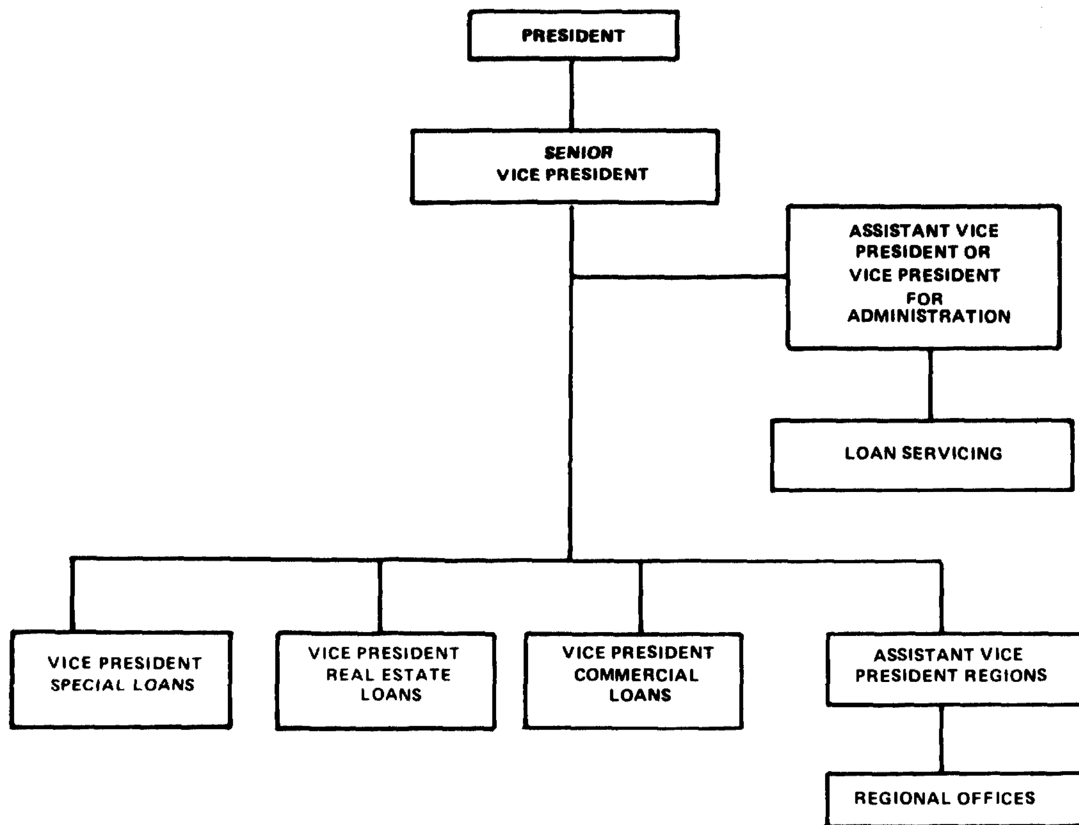
The only other major organizational change in 1981 resulted from the former Bank President's decision not to fill the position of Vice President for the Credit and Lending Department. According to the former President, she made this decision because an assistant vice president in this department could not work effectively with the two previous vice presidents. She said that she decided to abolish the Vice President for Credit and Lending position and to create two separate vice presidential positions, one for housing loans and one for commercial loans.

ORGANIZATIONAL PROBLEMS IDENTIFIED IN STUDIES BY OUTSIDE GROUPS

The adequacy of the Bank's organization has been studied recently by both PMM and FCA. Although the two organizations had different study objectives, each identified deficiencies in the way the Bank was organized to carry out its lending function and the capabilities of its lending staff. PMM identified certain other organizational and operational problems.

The Bank contracted with PMM in February 1982 to evaluate the Bank's organizational structure and management activities and recommend improvements. The study was to include topics such as organizational structure, lines of accountability and responsibility, supervision and monitoring, and performance evaluation. PMM issued a report on this work in June 1982. Subsequently, the Bank contracted with PMM to evaluate its regional operations. PMM reported on their work in February 1983. FCA's primary objective was to assess the quality of the Bank's portfolio. It issued its report in October 1982.

In assessing the lending process, PMM said that the dispersion of the functions of producing, developing, analyzing, granting, and managing loans among the Bank's regional offices, lending divisions, and Loan Committee caused duplication of staff effort. Greater efficiencies can be achieved, it said, by unifying the flow of loans to the extent possible into a single unit. To accomplish this, PMM recommended the following organizational structure.



FCA identified organizational weaknesses similar to those PMM identified. FCA reported that the absence of a supervisory position clearly responsible for administration and coordination of the credit function was a weakness in the Bank's organizational structure. FCA said that regional office staffs were directly accountable to a Vice President for Regional Operations, a central office position not employed in a credit capacity, and therefore the regional staffs were formally removed from direct supervision by senior credit officers. One result of this organizational weakness FCA identified was the frequent exclusion of senior credit personnel from the front-end loan decisions and early responsibility for loan supervision activities.

Other PMM recommendations to correct identified organizational and operational problems include the following:

--Hire a Director of Operations to develop an automated financial and management information system.

--Reevaluate the goals of certain regional offices or consider closing those offices.

--Consolidate the Bank's nonlending units under a senior vice president.

BANK ACTIONS TO CORRECT PROBLEMS

The Bank has already taken action to correct some of the organizational weaknesses identified by PMM and FCA. Subsequent to PMM's first report and during and after FCA's study, the Bank hired two vice presidents for its Commercial Lending and Real Estate Lending Divisions. It also created a new vice president position for special loans and filled that position by contracting with a former Senior Vice President at the Central Bank for Cooperatives. In commenting on the FCA study, the Bank stated that this centralized control over problem and special credit functions will enable the Bank to provide needed supervision over credits that need more than normal servicing and collection procedures.

Subsequent to PMM's second report, the Bank took steps to unify the lending process under one organizational head. Effective April 8, 1983, the Bank changed its organizational structure implementing, with one exception, PMM's recommended structure. This change involved the creation of a new Senior Vice President position and a new Vice President for Loan Administration position. The Bank did not, however, create a new assistant vice president position for overseeing regional operations as recommended by PMM. Instead, the regional directors report directly to the Senior Vice President. In conjunction with these changes, the Bank closed five of its eight regional offices and established branch offices in Atlanta, Georgia, and Dallas, Texas. (See p. 40.)

In announcing these changes, the Bank's Executive Vice President said that these steps will improve the Bank's lending procedures, ensure a quality loan portfolio, spur cooperative development, reduce overhead, and reinforce the Bank's ability to meet its financial obligation to the federal government. He highlighted the fact that in August 1981 the Congress stopped providing appropriated funds to the Bank but neither altered the Bank's mandate to do business nationwide nor provided it with sufficient resources to maintain the present regional system.

Concerning another PMM recommended organizational change, the Bank created and filled a Director of Operations position to develop an automated financial and management information system.

CONCLUSION

The Bank's organizational structure has changed significantly in its 3-year existence. It has evolved from a structure patterned after the enabling legislation where separate offices administered titles I and II programs to a structure where they are jointly administered by the Bank's staff. Unifying the lending process under one organizational head and hiring more highly qualified credit personnel should improve the Bank's lending

practices, increase the quality of its loan portfolio, reduce the processing time for making loans, and increase coordination.

BANK COMMENT

The Bank stated that it agrees with our conclusion that unifying the lending process under one organizational head and hiring more highly qualified credit personnel should improve the Bank's lending practices, increase the quality of its loan portfolio, reduce the processing time for making loans, and increase coordination.

CHAPTER 4

TITLE II ACTIVITIES LOSE VISIBILITY

Although the Bank in its initial organization established a separate Office of Self-Help Development and Technical Assistance to carry out title II activities, and until December 1982 the Bank's organization charts consistently identified it, the Office was effectively eliminated in June 1981 when the Bank merged titles I and II lending functions. Aside from management of title II loans, emphasis given to title II activities continued to decrease after the Bank's legal status changed on December 31, 1981. In August 1981 the Congress required the Bank to establish a separate nonprofit self-help corporation to administer title II activities. This new corporation, incorporated in December 1982, may help restore visibility to title II activities if it obtains necessary funding.

ESTABLISHMENT OF THE OFFICE OF SELF-HELP DEVELOPMENT AND TECHNICAL ASSISTANCE

Title II of the National Consumer Cooperative Bank Act (12 U.S.C. 3041) initially established an Office of Self-Help Development and Technical Assistance within the Bank. The office was to provide

--capital investment loans to higher risk cooperatives and organizations that could not meet the statutory requirements of creditworthiness imposed for title I loans;

--interest supplement loans to cooperatives that could not pay a market rate of interest but satisfied the Bank's definition of selling goods or services to, or providing facilities for, low-income people; and

--technical assistance to cooperative members, managers, and staff.

Sections 204 through 208 of title II also require and/or authorize the Self-Help Office to provide outreach such as organizational assistance, investigations of new types of services for cooperatives, financial analysis and market surveys, training and assistance to cooperative directors and management, and coordination with federal programs offering assistance to cooperatives.

The Bank established and staffed the Self-Help Office, and title II activities officially began, in August 1980--about 5 months after the Bank made its first title I loan. At that time, the Bank finalized the title II policies and the Office approved its first title II loan. According to the Bank act, the Self-Help Office was to be headed by a director appointed by the President of the United States. Although the Congress established the Bank effective August 1978, the first director was not appointed until September 1980. In October 1980 the Bank Board of Directors swore him in, but he worked full-time at the Bank only until January

1981. The Self-Help Director, however, did not resign, and the President of the United States did not appoint a replacement.

Because of this delay, the Bank had begun providing assistance to eligible cooperatives as early as June 1980 using title I's technical assistance authority, according to the former director of the Office's Technical Assistance Division. Similarly, the Bank approved title I loans to title II-type borrowers in emergency situations as early as April 1980 according to the Bank's Assistant Vice President for Loan Servicing. The Bank transferred 12 of these title I loans valued at about $3.4 million to the title II portfolio in January and February 1981. In April 1981, the Bank Board abolished its Self-Help Committee and combined titles I and II lending activities into a single Credit and Lending Committee. The Board took this action at the request of the Chairman of the Self-Help Committee in the interest of better coordination between the titles. In June 1981 the Bank essentially abolished the Self-Help Office when it reorganized and merged titles I and II lending functions and staffs. At the same time, the Bank selected one of the employees of the Self-Help Office to head the Office with the new title of Self-Help Coordinator. In the August 1981 amendments to the Bank act, the Congress required the Bank's Board of Directors to establish a nonprofit corporation to perform the functions previously performed by the Self-Help Office.

In April 1982 the Bank abolished the Self-Help Coordinator's position. According to the Executive Vice President, the Bank then assigned responsibility for title II nonlending activities to several divisions, primarily the Marketing and Regional Operations Divisions. Also, the Office of General Counsel was directed to prepare for incorporation of the self-help corporation, called the Consumer Cooperative Development Corporation (CCDC), which was incorporated in December 1982. The Bank had initially intended to establish the corporation in May 1982 but, as explained on page 31, did not do so.

CONFUSION OVER THE ROLE OF TITLE II

One area which lends itself to confusion has been the mission of title II versus title I. Some members of the cooperative community view title I as the hard loan window, making loans to cooperatives at market rates. Conversely, some view title II as the soft loan window, making developmental loans to low-income, emerging, or new venture cooperatives at subsidized rates. Critical analysis of the Bank act, however, does not fully support such clear differentiations.

For example, the Bank has made title I loans to low-income, emerging, and new venture cooperatives. This is consistent with the act's directive that the Bank use title I to "encourage the development of new and existing cooperatives eligible for its assistance by providing specialized credit and technical assistance; . . . ." The act further requires the Bank's Board of Directors to use their best efforts to ensure that at least 35 percent of outstanding title I loans are categorized as low

income.[1] The following table shows loans outstanding as of the end of fiscal year 1982 for titles I and II.

Loan Dollars Outstanding[a]

	Total loan dollars (in thousands)	Low-income loan dollars (in thousands)	Percent of low-income loan dollars
Title I	$75,661	$37,485	50
Title II	8,403	5,830	69
Total	$84,064	$43,315	52

[a]As of December 31, 1982 (the Bank's fiscal year coincides with the calendar year).

On the other hand, CCDC can make market interest rate loans under title II. In our opinion the basic difference is that title I loans are for creditworthy cooperatives at market rates and title II loans are for cooperatives which are a higher credit risk and serve low-income people. According to section 203(c) of the Bank act, the Bank Board may approve subsidized interest rates on CCDC's title II loans.

As stated above, title I authorizes the Bank to provide technical assistance to new and existing cooperatives even though title II created an Office of Self-Help Development and Technical Assistance within the Bank to also provide such assistance. According to the former director of the Technical Assistance Division, the Bank began providing technical assistance under its title I authority beginning in June 1980 before title II had become operational. The Bank did not finalize the title II policies until August 1980. According to the Bank controller, from the beginning of the technical assistance program, the Bank never differentiated between titles I and II technical assistance. The Bank believed that this was not necessary because, although the authorizing legislation specified separate amounts for each title, the Congress combined funding for administrative expenses for titles I and II, including technical assistance, into one appropriation.

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[1]According to the Bank's definition, low-income cooperatives are those which not only encourage the membership and participation of low-income persons but also (1) are located in a census tract or tract subsection where an individual's family income is equal to or less than the U.S. Labor Department's lower budget for a family of four for that region or (2) operate or propose a cooperative facility where at least 50 percent of the patrons are or will be low-income persons. In April 1983 the Board announced that it was considering revising the Bank's low-income definition.

The Bank Board had to deal with the issue of what is a title I versus a title II function when it adopted the Bank's 1983 budget. Because CCDC was incorporated in December 1982, the Bank had to try to establish separate budgets for the two separate entities. Previously, the Bank merged all administrative expenses regardless of whether they were title I expenses or title II expenses. However, the Bank Board had not yet made certain basic organizational decisions in areas such as CCDC staffing and Bank operational support to CCDC. Consequently, the Bank presented its budget based on two definitions of what CCDC's cost allocation could be:

--A narrow definition to include all costs associated with title II loans and services to title II constituencies.

--A broader definition to include all costs associated with activities formerly assigned to the Self-Help Office under title II, including all professional services spending, research, financial analysis and market surveys, and training for cooperative boards of directors and staffs.

Using the narrower definition, the Bank allocated 25 percent ($2.5 million) of its 1983 administrative expenses ($9.9 million) to CCDC. Using the broader definition, the Bank allocated 42 percent ($4.2 million) to CCDC.

According to the Assistant Vice President for Marketing, much of the nonloan activity to be provided by CCDC under title II is the type of activity that the Bank would have to conduct to meet its title I mandates. For example, the Bank would fund pilot projects (described on p. 28) even if they were not specifically authorized under section 205 of title II. These pilot projects should help identify and/or develop markets for future title I loans.

Several recent Board actions indicate that the Board is showing concern for the needs of low-income cooperatives. The Board-approved Marketing Division plan calls for the staff to begin to identify opportunities for cooperative development in low-income communities in 1983. At its December 1982 meeting, the Board directed that Bank staff explore lending to low-income community health centers in 1983. In March 1983 the Assistant Vice President for Marketing reported that the Bank would be co-sponsoring a week-long business development seminar that will teach business planning skills to low-income, rural enterprises, including cooperatives.

OUTREACH EFFORTS CURTAILED

In December 1981 the Executive Committee of the Board directed the President to reduce the level of Bank expenditures. Similarly, in January 1982, the Board of Directors approved a new operating plan for the Marketing Division--the section of the Bank whose mission is to develop replicable models of well-functioning cooperatives, stimulate new markets for Bank loans, conduct research on industries to which the Bank is now lending, and

provide existing shareholders and the public with current information about the cooperative sector and Bank services. The plan acknowledged that the change in the Bank's legal status "had resulted in an elimination of government-funded technical assistance and also in an increasingly business oriented focus necessary for the Bank to achieve self-sufficiency in market terms." The Executive Vice President told us that as a result of the reduced federal funding, the Bank reduced its expenditures for nonincome-producing activities, such as the outreach or developmental activities called for in the Bank act.

The Bank has performed many of the title II outreach or developmental activities under contract. For example, Marketing Division records identified 42 contracts which had been awarded to outside parties for various title II nonloan activities as of December 31, 1981. These activities included providing technical assistance to retail and wholesale consumer cooperatives, studying the feasibility of regional loan funds, printing outreach brochures, and evaluating marketing efforts with rural cooperatives.

The Marketing Division also carried out some outreach activities as part of its day-to-day operations. For example, the Division has a toll-free telephone number which interested parties can use to request information on cooperatives from the Information Officer. The Bank also distributes reference materials produced by other groups. For example, it has distributed information on

--energy cooperatives from the Department of Energy,

--housing cooperatives from the Federal Home Loan Bank Board, and

--cooperatives organization from the Cooperative League of the USA and the former Office of Economic Opportunity.

The Bank has produced and distributed brochures on the role of labor unions, religious organizations, and senior citizens groups in organizing and assisting cooperatives. The Marketing Division was not able to estimate how often it sent materials to requestors. Marketing also sends copies of reference materials to the Bank's regional offices for distribution by them to interested parties.

The Bank conducted a series of student cooperative conferences at five colleges and universities in 1981. The former President reported to the Board in June 1982 that the results of the conferences were disappointing. Also, the former Boston Regional Director told us that the Boston region sponsored two student conferences but neither produced any loan activity or requests for technical assistance. The Bank did not conduct any of these conferences in 1982 and none were planned for 1983.

Technical assistance revised

As discussed earlier, the Bank shifted responsibility for cooperative-specific technical assistance--one of the primary functions of the Self-Help Office--from headquarters to the regions in June 1981. Since that time the Bank has also changed the focus of such technical assistance and its method of delivery. Cooperative-specific technical assistance includes reviewing financial and business operations, reviewing accounting systems, assessing marketing plans, and training cooperative Board members.

The Technical Assistance Division provided the Bank's technical assistance through outside contractors before the Bank delegated primary responsibility to the regions. The former Vice President for Regional Operations said that the transfer to the regions went well and that all regions but Detroit had technical assistance officers on board by June 1981 to handle the increased responsibility. The former Vice President said that the Bank hired the technical assistance officers in anticipation of this delegation. Regardless of the Bank's intent, some members of the cooperative community may have perceived this action as a deemphasis of the Bank's commitment to provide technical assistance.

Prior to this time, the Bank subsidized all cooperatives by providing technical assistance from outside sources at less than the full cost. Also, low-income cooperatives were eligible to receive such assistance at less cost than other cooperatives. In June 1981 the Bank changed its policy and began to charge all cooperatives, with certain exceptions for low-income cooperatives and hardship cases, for the full cost of providing outside technical assistance.

As a result of the August 1981 amendments to the Bank's charter which among other things eliminated federal appropriations for administrative expenses, the Bank undertook a Bank-wide reduction of nonincome-producing activities. At that time, the former Vice President for Regional Operations stated that the Bank's ability to allocate income for contracting out for technical assistance would be severely limited. The former Vice President directed the regional offices to assign top priority for use of technical assistance funds to loan administration. Loan development technical assistance was to be used only for loans that could meet the Bank's underwriting criteria. The regions were also directed to provide more direct assistance using regional staff as opposed to contracting out.

In October 1981 the Bank further refined its technical assistance policies. The Bank also sent a discussion paper to the regional directors soliciting their comments. The paper stated that the technical assistance goal was to provide the expertise and support needed to achieve the Bank's 1982 marketing and lending goals within the limitations of available resources. The paper noted that "Technical assistance is to be a means to

specific portfolio-related program goals, . . . rather than a general 'co-op support' end in itself."

Under the revised policies, the former Vice President for Regional Operations directed the regions to be more selective in the use of assistance funds. They were told that technical assistance should only be delivered to projects which looked like good prospects for committee approval. Regional staff were told to perform needs assessments, prefeasibility studies, and similar activities to the maximum extent possible, rather than use contractors. The regions were also told to refer some cooperatives to other sources of assistance rather than use Bank funds.

At the request of the regional directors, the Bank authorized the regions to spend up to 20 percent of technical assistance budgets on developmental (nonloan-related or general) technical assistance if (1) the region determined that the assistance was critical in terms of cooperative development and long-term regional loan prospects and (2) the cooperative could repay 100 percent of the cost plus a 20-percent charge for overhead. The Bank intended for this overhead charge to defray the Bank's costs of providing assistance to groups that were not potential borrowers. The former Vice President for Regional Operations advised the regional directors that the developmental budget was an option rather than a goal and cautioned that regional performance would be measured based on achievement of the region's lending goal, not the amount of developmental assistance the region provided.

The former Director of Regional Operations told us that she did not know of any cooperatives that had received technical assistance which required the 120 percent charge. She stated that this was probably because nonloan-related technical assistance had third priority during this period. The Bank had directed the regions to give preference to technical assistance in connection with loan management and loan development with good loan prospects.

Thus, these actions limited the availability of assistance. For example, in June 1982 one region wrote a memorandum responding to an applicant cooperative which stated that

> ". . . the NCCB has changed its technical assistance policy. We only provide assistance to eligible cooperatives that are actively seeking loans from the Bank. This, therefore, precludes our working with developing cooperatives which do not possess clearly established, feasible loan potential."

When the Regional Operations Division released its professional services manual in June 1982, it reflected a new technical assistance pricing policy. Since that time the Bank policy has been that 100 percent of a contractor's cost for delivering technical assistance will generally be charged to the cooperative. The policy makes allowances for hardship situations which may involve low-income or startup cooperatives. It allows less than full repayment (no less than 50 percent) or

longer term repayment in some instances. At the discretion of the regional director, an overhead charge to cover the cost of Bank staff time may be added to technical assistance fee agreements. The Bank pays the full cost of needs assessments and does not charge cooperatives for assistance provided by Bank staff.

In accordance with these policies, regional staff told us that they now provide much technical assistance directly to cooperatives rather than using contractors. Where possible, the regional staff tries to direct cooperatives needing assistance to non-Bank sources which in some cases provide cost-free assistance to the cooperatives. These sources include cooperative federations, small business development centers at colleges and universities, and federal government agencies such as the Small Business Administration or the Minority Business Development Administration. The former Vice President for Regional Operations said that the regions sometimes team up new or emerging cooperatives with experienced cooperatives in the same sector. In this manner new cooperatives can get firsthand experience in cooperative operations.

In a March 1983 survey of the regional offices, the regions reported to the Regional Operations Division that they provided "substantive" technical assistance directly or through contractors to at least 211 cooperatives as a part of loan development, loan management, or in nonloan-specific assistance in 1982. For purposes of this survey, Regional Operations defined substantive assistance by regional staff as that involving at least 8 hours of staff time.

In line with the Bank's cost-cutting measures, total Bank expenditures for technical assistance provided by contractors decreased substantially from fiscal year 1981 to fiscal year 1982. Technical assistance expenditure figures that the Bank considers confidential are contained in attachment II of a supplement to this report which we will not release to the public. Although the Bank continues to provide technical assistance, both the Bank's Executive Vice President and we believe that the adjustment in technical assistance policies has been one of the major causes of dissatisfaction within the cooperative community.

Pilot projects

The Bank has started seven pilot projects since the program began in 1980. Pilot projects are designed to fund the business planning stage for cooperatives investigating new markets. The Bank hopes that new services successfully tested in one area can then be replicated in other areas. To date the Bank has pursued pilot projects in the areas of cooperative involvement in suburban cable television; a retail food cooperative expanding into energy conservation, garden supplies, and hardware; consolidation of cooperative food distribution warehouses; an energy conservation supply cooperative selling home building materials; development of

a small inner-city shopping mall located next to an elderly housing project; a multiservice retail shopping center; and the use of manufactured housing components for housing cooperatives. An eighth pilot on a union-sponsored auto repair cooperative was awarded but later canceled before the Bank spent any funds.

The results of these projects have been mixed. The cable television pilot resulted in approval of three loans to the cooperative. The food warehouse pilot led to the merger of several food warehouses. Although the Bank decided that three other pilots were not feasible, the Bank's 1983 Financial Operating Plan states that the Bank prevented the cooperatives involved from wasting money on unworkable expansions. According to the Assistant Vice President for Marketing, the Marketing Division undertook only one new pilot in 1982 because of staff limitations. The Assistant Vice President told us that pilot projects require intensive monitoring, and the Division chose to defer more new pilots until the staff completed some of the ongoing projects. The Division has begun seeking proposals for additional pilot projects in 1983.

Cooperative training

In March 1983 the Assistant Vice President for Marketing reported to the Marketing Committee that the Bank drastically reduced training expenditures following the elimination of federally funded technical assistance. In 1982 the main training activities were the intensive 3-week course for managers of consumer cooperatives and technical seminars at the Consumer Cooperative Managers Association. The Bank plans to continue partial funding of these courses in 1983 and evaluate and consider funding for other cooperative conferences or training courses.

Minority outreach lacked coordination

Although the Bank reduced some of its outreach effort in 1982, the Bank retained the minority outreach efforts of its former Director of Community Affairs. As such, he was responsible for nationwide outreach to groups such as minorities and students. The Bank stationed the Director of Community Affairs in Atlanta, Georgia, so he could serve the southeastern states, an area which did not and does not have a well-developed cooperative borrowing base. He traveled throughout the Nation addressing conferences, conventions, and similar gatherings and distributing publications about the Bank. In March 1982 the Bank abolished the Director of Community Affairs position but then contracted with him to continue his outreach efforts part-time. The Executive Vice President told us that this personnel action was part of a Bank effort to reduce its general outreach expenses by 50 percent.

During our visits to the Bank's regional offices, we found the former Director's activities were not always coordinated with the regions. The Oakland Regional Office Director said that he did not know that the former Director had planned to visit that

region in August 1982 until after the former Director completed the visit. The Regional Director said that if he had known of his visit he might have had the former director introduce him to minority or civic leaders as he had on an earlier visit to the Oakland Region. Similarly, the Boston Regional Office Director did not know that the former Director had attended a conference in Boston in July 1982 until we told her in November 1982.

To give the Bank the opportunity to increase the usefulness of the time remaining under the contract, we met with the Bank's Executive Vice President in November 1982 after we completed our field visits and discussed the need for better coordination. He said that the Bank sent a schedule of Bank officials' trips to the regions and that the former Director should have been included on it. The Executive Vice President assured us that he would direct the former Director and/or the Marketing Division to coordinate all future trips with the appropriate regional directors. The Bank did not renew the minority outreach contract when it expired in March 1983.

ESTABLISHMENT OF THE CONSUMER COOPERATIVE DEVELOPMENT CORPORATION

Although the Bank Board established CCDC in December 1982, some 16 months after the Congress passed the authorizing legislation, questions concerning the selection of its Board of Directors, staffing, and administrative funding were unresolved in May 1983. Although Board members were selected in August 1983, visibility for title II activities is still lacking.

Composition of corporate board

The 1981 Bank act amendments required the Bank Board to establish a nonprofit corporation under the laws of the District of Columbia and to name the directors of the corporation. The amendments also provide that any member of the Bank Board may serve on the corporation's Board.

Under this mandate, the Bank Board at the first meeting of its former Self-Help Committee directed the Office of General Counsel to draft articles of incorporation in March 1982. The articles as drafted in April 1982 provided that the corporation's Board should be limited to the members of the Bank Board's Self-Help Committee (five at that time), the Chairman of the Bank Board, and the Bank President. The Bank's then General Counsel told us that the District of Columbia Nonprofit Corporation Act would allow the Bank Board to name the Bank President to the corporation Board and that the authority to name the other Bank Board members to the corporation board came from the Bank act or its legislative history. Section 211(b)(4)(B) of the Bank act, as amended, states that "any member of the Board of Directors of the Bank may serve as a member of the Board of Directors of such nonprofit corporation." Along with providing for membership by Bank Board members, the conference report on the Omnibus Budget Reconciliation Act of 1981 (H.R. Rep. No. 208, 97th Cong. 1st Sess. 720 (1981)) states that "the board of directors of the

corporation will be appointed by the board of directors of the Bank from representatives of cooperatives eligible for assistance from the corporation." The report does not define who can qualify as a representative.

In May 1982 the Board's former Self-Help Committee directed that these draft articles be amended to provide for an unspecified number of additional members who could be drawn from non-Bank Board members. At the same time, all Bank Board members were made eligible for the Corporation Board. On May 19, 1982, the Chairman of the House Banking Committee sent a letter to the Chairman of the Bank Board strongly objecting to these plans. The Committee Chairman stressed the need for Board members selected primarily from cooperatives eligible for title II assistance and urged the Bank to reconsider its plans.

After receiving this letter, the Board postponed incorporation of the CCDC and decided to give shareholders and the public more opportunity to provide oral and/or written comments on the proposed articles of incorporation and bylaws of CCDC. The Bank held public comment sessions in Kansas City (Sept. 1982) and New York City (Oct. 1982) for interested parties to address the Bank Board. Also, the Bank included a notice of these sessions in the September 1982 issue of its newsletter, Co-op Bank Notes, which it mails to about 14,000 readers. The Bank mailed copies of the draft articles and bylaws to each of its shareholders (229 at the time of the mailing) prior to the September 1982 meeting.

In response to these efforts, the Bank received written or oral comments from only 38 individuals and organizations. The Bank staff organized, summarized, and presented the comments to the Board in November 1982 for its consideration together with staff recommendations. Several commenters advocated a CCDC not controlled by the Bank Board.

Because the Bank Board had not yet decided on the number of non-Bank Board members who would sit on the CCDC Board, the Bank Board decided to file articles of incorporation for CCDC which provide for an initial interim Board consisting of all the directors on the Bank Board. The articles provided that the initial Board would serve until April 1, 1983, or until their successors were elected or appointed. On April 15, 1983, the CCDC Board approved bylaws which stated that the CCDC Board shall have nine directors. Of these nine, the Bank Board shall appoint six directors from among the Bank's Board of Directors and three directors who are not members of the Bank Board.

Although the Bank filed for incorporation of CCDC in December 1982 and the Bank Board of Directors serves as an interim CCDC Board of Directors, CCDC is only now getting off the ground. For example, the Chief Operating Officer who will be responsible for the day-to-day operations of CCDC has not been hired. In February 1983, the interim CCDC Board appointed the Bank's Executive Vice President as the interim Executive Director. The CCDC Board tentatively decided in March 1983 that in the future the Bank President would also be the Chief Executive Officer and

Executive Director of the CCDC. The Bank's new President was elected as CCDC Executive Director on June 17, 1983. The CCDC Board also decided that CCDC would have a professional staff comprised of a chief operating officer and headquarters low-income development specialists. To date no separate CCDC staff has been hired. All the title II functions which the Bank act requires CCDC to perform are done by Bank employees under a management reimbursement agreement (discussed below) approved in December 1982 by the Boards of the two institutions. Consequently, we believe title II still lacks visibility and accountability.

Funding CCDC administration

Although several potential sources of funding are available to CCDC, the corporation's future administrative funding remains uncertain. A discussion of possible funding sources follows.

First, the act authorizes the Bank's Board of Directors to provide tax-deductible contributions to CCDC out of Bank earnings except that

> ". . . the Bank shall set aside amounts sufficient to satisfy its obligations to the Secretary of the Treasury for payments of principal and interest on class A notes and other debt before making any contribution to such nonprofit corporation."

In December 1981 the Bank estimated title II's share of the Bank's administrative expenses for calendar year (Bank fiscal year) 1982 at $3,994,200, or about 34 percent of the total Bank budget. To help determine what future tax-deductible contributions it would provide to CCDC, the Bank surveyed its employees during April 1982, and asked them to allocate their time between titles I and II activities. The survey did not, however, provide usable results because of staff confusion over allocating their time and inadequate responses.

In March 1983 the Vice President for Financial Administration estimated that the annual subsidy or loss from CCDC operations was $3,343,000. This amount represents about 34 percent of the Bank's $9.9 million budget for 1983. Also, in March 1983, the Bank surveyed its staff to again try and determine what portion of Bank administrative expenses may be allocable to CCDC under the management reimbursement agreement. Under this agreement, the Bank agrees to provide services to CCDC such as processing applications for financial and technical assistance; disseminating information about CCDC; providing quarters and technical services; providing accounting, personnel, procurement, and other administrative support; and providing legal advice. The new survey form also asked staff to determine what amount of the time charged to both the Bank and CCDC was devoted to low-income work. The results of the survey were unavailable at the time we completed our work.

Such an arrangement is consistent with the Bank act's legislative history which states that the Bank and the self-help

corporation should avoid unnecessary duplication of staffing and functions. According to the Ominibus Budget Reconciliation Act of 1981 conference committee report, the committee anticipated that the corporation and the Bank would be housed together and that the corporation would use the Bank's regional offices to disseminate corporation information and process corporation loans. Under the Bank act, the Bank could be reimbursed for its expenses or the cost of the Bank's efforts could be treated as a tax deduction to a charitable institution.

Second, the act authorizes the corporation to accept tax deductible contributions from non-Bank sources. These contributions could include general purpose grants or various kinds of grants from foundations, church groups, pension funds, and mutual insurance companies which would be tied into specific projects.

Third, the act specifies that fees collected for technical assistance services may be used for corporation expenses, including administrative expenses. Fourth, the Bank's former General Counsel told us that CCDC would be able to use title II principal amounts to fund administration. However, the Bank Board's former Self-Help Committee agreed in March 1982 that "none of the principal of the [title II] Self-Help Fund should be used now or in the future for [CCDC] operating expenses."

Thus, although CCDC has several potential sources of funds available, it will probably rely to a great extent on the subsidy from the Bank. Bank Board members and senior Bank officials have stated that the Bank is willing to make substantial contributions to support CCDC. However, as discussed in chapter 10, the Bank may need its resources to meet its own obligations. Therefore, in the future, the Bank Board may be unwilling or unable to support those nonloan title II activities which do not directly support the Bank's lending goals, especially if recent past actions in reducing the number of regional offices and regional staff (see p. 40), reducing the availability of general technical assistance, curtailing training for cooperatives and students, and reducing outreach are indicative of future events.

CONCLUSIONS

In general, the Bank's emphasis on title II activities has decreased since the June 1981 reorganization, and the title II activities have lost visibility. Because of the loss of federal funding for administration, the Bank has curtailed outreach efforts and revised its technical assistance policies. CCDC, however, could restore title II activities once questions such as staffing and administrative funding are resolved.

BANK COMMENTS AND OUR EVALUATION

The Bank said that while it is not satisfied with the effectiveness of its title II activities, it has strived to live up to its developmental mandate under extremely difficult circumstances. Title II activities were hampered, it said, by (1) the Carter and Reagan administration's failure to appoint a Director

for the Self-Help Office, (2) indications that the work of the Self-Help Office was duplicative and uncoordinated with the Bank, and (3) the loss of federal funding for the office. The Bank also said that we seemed to criticize the Bank's commitment of resources rather than results and did not give sufficient weight to the time required to measure success of development work.

At the request of the Chairman, House Committee on Banking, Finance and Urban Affairs, our review focused on the staffing, direction, and emphasis provided to title II activities. Our report, therefore, discusses the changes in the Bank's title II activities together with the Bank's reasons for making the changes. Our report also presents the results to date of efforts such as the pilot project program but does not express an opinion of the efficacy of such programs as a vehicle for long-term cooperative development. We agree with the Bank, however, that cooperative development is a labor-intensive long-term effort.

Concerning the new Consumer Cooperative Development Corporation, the Bank said that it shared our belief that the corporation should correct any misconception that the title II program is not being actively pursued. This statement does not accurately reflect our conclusion. We stated that CCDC may help restore visibility to cooperative development and outreach activities but, to date, it is unclear whether the corporation will receive adequate funding to do so. Although the Bank said that it can and will provide CCDC with adequate support in the near term while alternative financing arrangements are developed, its past actions such as reducing the number of regional offices and staff, curtailing training for cooperatives and students, and reducing outreach indicate otherwise.

CHAPTER 5

REGIONAL OPERATIONS CONTINUE TO EVOLVE

The role of the Bank's regional offices has evolved since they opened and their responsibilities and authority have increased. Also, our review of four regional offices showed that regional operations differed considerably reflecting the level of cooperative development and the size and quality of the Bank's loan portfolio in each region. The Bank implemented major revisions to regional operations as part of its April 1983 reorganization.

At the time of our review, the Bank had eight regional offices to fulfill its mandate as a national bank. The regional offices were under the direction of the Vice President for Regional Operations headquartered in the central office. The Director for Regional Operations assisted the Vice President. Generally, each regional office was headed by a regional director and staffed by one or more loan officers, loan development officers, and administrative support staff. The regional offices were responsible for primary contact with Bank customers and borrowers, conducting business development activities, loan development and analysis, and loan management.

Since the regional offices opened, they had been delegated increased responsibility for technical assistance and origination and management of commercial and real estate loans. The Executive Vice President stated that in the first 2 years of operation, the Bank applied a strategy that used regional staff as the major vehicle for cooperative development within the Bank. The Bank allocated each regional office essentially the same level of staff and technical assistance resources regardless of the maturity of the cooperative market in the particular region. The conscious strategy was to devote the same level of resources in the developmental markets (Southeast, Southwest, New England, Northwest) as in the mature markets (Mid-Atlantic, Midwest, Great Lakes, and West) to support the emergence of new cooperatives as well as strengthening the existing cooperative base.

BUSINESS DEVELOPMENT ACTIVITIES REFOCUSED

Our visits to the regions showed that business development activities had been recently refocused. Business development includes meetings, conferences, telephone calls, and visits to inform groups or individual cooperatives of the Bank's services. Business or nonloan development outreach to the cooperative community in general, which was characteristic of the Bank soon after it became operational, was deemphasized as the Bank redirected regional office resources to loan development. For example, during 1982 the Bank delegated to the regional offices responsibility for

--analyzing housing loan applications (limited to New York City, Seattle, and Oakland);

--denying loan applications not meeting Bank lending policies; and

--conducting preliminary eligibility determinations for loan applicants.

During 1982 the Regional Operations Division made several personnel and organizational changes. First, the Division reclassified regional staff holding the job descriptions of field representative or technical assistance officer. Field representatives had been primarily responsible for outreach and technical assistance officers had been responsible for monitoring technical assistance provided to cooperatives in the regions. The regions considered staff having these job descriptions for reclassification under a new job description called loan development officer. Loan development officers are primarily responsible for bringing new loan activity to the Bank.

As the Bank had recruited many regional staff with cooperative or community development backgrounds, they did not have lending expertise. Consequently, those field representatives which Regional Operations did not believe had the potential to readily acquire financial analysis and loan packaging skills were separated from the Bank along with some of the technical assistance officers. One technical assistance officer was reclassified as a loan officer because of his ability and experience according to the former Vice President for Regional Operations. Overall, 11 former field representatives and technical assistance officers left the Bank during 1982 because of the reclassifications and other reasons. Before the April 1983 reorganization, the Bank had 14 loan development officers.

The Bank also made an organizational change which affected its ability to perform outreach and interact directly with the cooperative community. Over the past 2 years, the Bank had closed 7 of its 12 original regional work stations. Work stations are one-person suboffices under the direction of the regions but not located in the same city as the regional office. The Bank initially established them to make it more accessible to the cooperative community.

The Executive Vice President told us that the Bank had learned that outstationing of regional staff had major managerial flaws. Given the difficult nature of the Bank's development and credit work, the Bank believed that the individuals in the work stations could benefit substantially from greater supervision and interaction with other professionals. The regional directors requested the transfer of outstationed staff into the regional office to provide better supervision and more efficient staff resource allocation.

We believe, nevertheless, that these changes reduced the Bank's ability to interact directly with current and prospective members of the cooperative community. For example, when the Southeast was handled by a regional office located in Charleston, South Carolina, the region had field representatives located at

work stations in Louisville, Kentucky; Jackson, Mississippi; and Atlanta, Georgia. Another field representative worked out of Charleston. By the middle of 1982, these four field representatives had left the Bank and the Bank had abolished these work stations to reduce administrative expenses.

Also during 1982, the Bank relocated the Charleston Regional Office to Atlanta and relocated the Fort Worth Regional Office to Dallas. The Director of Regional Operations said that the Bank relocated these regional offices to improve their efficiency and accessibility by locating in those cities which are the centers for activities, such as banking and transportation, within the region.

As a result of these changes, the regions had fewer staff to carry out the Bank's mission. The former President told us that the regions needed staff with a credit understanding so that they could readily identify viable lending proposals. The former President also said that the Bank no longer had the staff time to devote to developing marginal loan proposals.

The level of effort devoted to business development varied among the regions we visited. In New York, the regional director said that the two loan development officers had conducted systematic call programs where they initiated contact with the health, food, child care, education, and cable television sectors. For example, one loan development officer had contacted 50 health maintenance organizations which might be converted to a cooperative structure. The director told us that New York's two loan officers had little time available for business development work.

With only one active loan to manage, the Boston office had staff time available for business development. Regional staff told us that outreach was closely tied to finding potential borrowers. We reviewed the region's correspondence notebooks for 1982 and identified 236 outreach letters which the region had sent to potential borrowers as of our October 1982 visit. The region mailed letters to groups including private schools, private cable television cooperatives, auto clubs, country clubs, YWCA's, and hospital associations. The emphasis this region placed on business development was indicated in a January 1982 outreach letter as follows:

> "This coming year will be a critical one. Apart from the NCCB's need to sustain itself nationally, the regional offices will be evaluated as to the cost effectiveness of a decentralized system.
>
> The New England region is rich in potential for cooperative business development, but there are relatively few cooperatives with financial track records strong enough to borrow from our primary loan fund (Title I). The challenge in this region in the immediate future will be to generate a sufficient loan volume to justify

supporting the staff and other resources necessary to assist the expansion and diversification of cooperative businesses in consumer goods and services."

In Oakland, the Regional Director said that the staff did not do much business development because he considered their first responsibility to be loan management. He added that Oakland had more loans to manage than any other region (24 at the time of our visit), a higher percentage of title II loans, and many loans which the Bank considered "classified."[1] The region's only loan development officer told us that she had been able to do little development work since she had been in the Oakland region. She said that she had concentrated on managing troubled commercial cooperative loans.

The former Acting Regional Director in Atlanta told us that events in 1982 had been disruptive on the region's performance. In April of 1982 the former Regional Director resigned. There followed a period of uncertainty concerning if and when the Bank would relocate the regional office or close it. We visited the regional office in November 1982 shortly after it had moved from Charleston, South Carolina, to Atlanta and the regional staff were resuming loan development work that had been curtailed in April. The former Acting Regional Director said that he spent most of his time on loan management, but the loan development officer planned to begin outreach to the housing, food, and child care cooperative sectors.

LOAN DEVELOPMENT EMPHASIZED

Emphasis placed on loan development varied by region and sector of the cooperative movement. Loan development includes assisting cooperatives in developing loan applications and supporting documents, reviewing completed applications for adequacy, and making recommendations regarding loan approval or denial by headquarters. We found that the Bank restricted real estate loan development in some regions. The Bank, however, encouraged commercial loan development in all regions.

Cooperative housing is well developed in some parts of the nation, such as parts of California and New York City, and the potential demand for loans by the housing sector overall is great. Recognizing that the Bank could relatively easily loan much of its capital to housing cooperatives with little available for other types of cooperatives, the Congress restricted real estate lending in the Bank's charter. The charter provides that the Bank cannot approve additional housing loans after October 1, 1985, if total housing loans exceed 30 percent of the Bank's gross assets. To leave some funds available for the development of housing cooperatives in other parts of the nation, the Bank had

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[1]The Bank uses the term "classified" to include loans which are delinquent, in foreclosure, and those with other repayment problems.

restricted loans in certain locations where housing cooperatives were already well developed.

On the other hand, the Bank encourages sound commercial loans in all regions and has targeted five subject areas for emphasis in 1983. These are cable television, health care, child care and education, recreation, and cogeneration.[2]

For 1982 the Bank established an overall lending goal and assigned specific lending goals to each regional office. Detailed information on the Bank's 1982 lending goals and the Bank's and regional offices' progress toward meeting these goals that the Bank considers confidential is contained in attachment III of a supplement to this report which we will not release to the public.

An analysis of the Bank's progress in meeting its lending goals was presented to the Board's Credit and Lending Committee in January 1983 by the Bank staff. It showed that the Bank had failed to meet its goals and cited six factors which contributed to this shortfall. These were (1) loan commitments which the Bank never closed, (2) underestimations of time needed to develop loans, (3) problems in cooperatives meeting Bank eligibility standards, (4) evolving credit policy and criteria, (5) staff diverted from loan production to loan management, and (6) over-optimistic estimates of lending prospects especially in real estate.

LOAN MANAGEMENT GIVEN TOP PRIORITY

The former Vice President for Regional Operations directed the regions to give top priority to loan management. Loan management includes the periodic review of financial statements submitted by borrower cooperatives, site visits, and provision of loan-related technical assistance. We found that the impact of this directive varied by region.

According to the Assistant Vice President for Commercial Lending, the regions began to receive responsibility for managing commercial loans as early as December 1980. The Bank began to give some real estate loan management responsibility to the regions in April 1982. The headquarters Real Estate Lending Division staff continues to manage all real estate construction loans. We found that the staff in regions with several classified loans devoted much of their time to loan management responsibilities. The New York and Oakland Regions' loan officers and/or loan development officers at the time of our visit were spending most of their time on loan management especially for commercial loans. For example, one loan management file showed that New York regional staff had made 14 site visits to one

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[2]A cogeneration plant is an oil/gas-fired group of turbines which generates electricity for consumption by a complex (such as housing or hospital) and, as a by-product, recaptures excess heat to heat hot water or provide steam heat to the same complex.

commercial cooperative between March and August 1982. Similarly, the former Acting Regional Director of the Atlanta Regional Office told us that he spent most of his time on loan management. On the other hand, the Boston regional staff with only one active loan to manage was able to devote much time to loan development.

REGIONAL RESOURCES WERE VERY LIMITED

At the time of our field visits, the Bank had eight regional offices to identify and develop lending opportunities and offer its services throughout the United States, its territories and possessions, and Puerto Rico. The Bank located the offices in cities where it believed they could best serve the cooperative community (see footnote on p. 1). The Bank opened its first regional office in Oakland in October of 1980. All eight offices were operating by February 1981 but were not fully staffed until June 1981.

As of February 1983, the regions were responsible for from 3-1/2 to 12 states with professional staffs of from only two to six persons. Within these states and with this staffing, the regional offices were generally responsible for contacting Bank customers and borrowers, conducting business development activities, developing and analyzing titles I and II loans, and managing these loans. Also, the Bank made the regions responsible for providing technical assistance or referring cooperatives to other sources of assistance.

As an example, the Atlanta Regional Office was responsible for 12 southeastern states. The region had a professional staff of two--one loan officer who has also acted as regional director since the former director resigned in April 1982 and one loan development officer. Reflecting this staffing level, the Bank had advised the region to initially focus its loan development efforts in two states--Georgia and Florida. The region, however, was still expected to work with other cooperatives in the region, especially with regard to loan management. The amount of time available for these 10 other states was very limited.

Similarly, the Minneapolis Regional Office had a professional staff of two, no regional director, and 8-1/2 midwestern states to service. We recognize that these were the actual staffing figures rather than the authorized positions and that the Bank had attempted to recruit regional directors for these regions until August 1982. At that time the Board instructed Bank management to delay recruitment of the regional directors until a comprehensive review of the Bank's regional system was completed.

REORGANIZATION OF REGIONAL SYSTEM

The Bank Board and management had reexamined the role of the regional offices for some time. To evaluate the role of the regions in fulfilling the Bank's mission, the Bank contracted with PMM in January 1983.

The Board's former Self-Help Committee critically discussed the role of the regions at its December 1982 meeting. The Committee acknowledged that a regional delivery system was very expensive and questioned whether the Bank could justify the continuation of the present structure based on the level of loan activity the regions develop. The committee further questioned whether CCDC could afford to pay for a regional structure to perform its outreach function because of CCDC's limited resources. In short, if the regions cannot pay for themselves by developing sound Bank loans and if CCDC cannot afford to support the regions, what was the future role for the regions?

PMM issued a report in February 1983 which contained numerous recommendations for revising regional operations. In March 1983 senior Bank staff presented the report along with their recommendations on its findings to the Board's ad hoc Regional System Policy Committee and the full Bank Board. The Board had established this committee in October 1982 to review policy issues posed by the Bank's regional office system.

The Bank's Vice President for Financial Administration presented a profitability analysis to two Board committees in February 1983 which showed the net contribution from or subsidy to each of the Bank's profit centers in 1982. For purposes of this study, the Bank had 10 profit centers: nine lending centers (the eight regional offices and the Washington, D.C., Service Area) and the Bank's investment portfolio. Using a model developed by PMM, the study showed that only three of the Bank's lending profit centers generated a positive net income in 1982 when lending income and expenses, direct and indirect development expenses, and loan loss expenses were allocated to the centers. The three profit-generating lending centers were the Detroit and Minneapolis regional offices and the Washington, D.C., Service Area. The study concluded that the investment portfolio essentially subsidized lending activity in 1982.

The Vice President presented a revised regional profitability analysis to the Board in March 1983 which updated the previous version for 1983 and presented revised conclusions. The new report concluded that:

--The Bank's lending operation was losing $9.6 million (net subsidy) on an annual basis at the current level of outstanding loans and expenses.

--All nine lending centers generate a net contribution if only cost of funds and loan loss expenses are considered.

--None of the lending centers generate a positive net contribution when lending expenses are allocated to the lending centers.

On April 7, 1983, after we had completed our field visits, the Executive Vice President announced a reorganization of the Bank and a reduction in the size of the Bank's regional system.

The number of regions decreased from eight to three. The Bank decided to maintain full service regional offices in New York City, Minneapolis, and Oakland because these are the areas which show the greatest existing loan activity and potential for growth, according to the Executive Vice President. The Bank will also operate two smaller branch offices in Atlanta and Dallas which will report to the regional offices. These branches are to continue as focal points for contact with shareholders, and they are to identify key organizations and business partners to assist the startup of new cooperatives. The Bank abolished 23 of 51 positions, about 45 percent, in the regional system during the reorganization.

In explaining the reorganization, the Executive Vice President stated that the reduction in overall resources available to the Bank forced the Board and management to reconsider its development strategy. The results of the regional development activities were limited in that few cooperatives in the developmental regions had developed to the point of seeking financing. Therefore, the Bank decided that an alternative development approach should be tried in the interest of the cooperative community. This alternative approach has two major components:

--A more centralized approach to development, using the Marketing Division staff and the new CCDC staff of cooperative development experts.

--A reduction and redirection of regional development resources.

The Executive Vice President stated that while the Bank reduced overall resources devoted to the regional system's development activities, they were not eliminated. The new structure increases the time the Atlanta and Dallas staffs will have available for development since they are no longer responsible for loan management. As we noted, loan management had absorbed much of the staff time in the Atlanta office. Essentially, the new regional structure places 2 staff years devoted to development in each of the five offices with additional lending staff in the three major offices.

The Executive Vice President also said that this net decrease in regional developmental resources would be partially offset by an increase (present and planned) in headquarters development resources. While increased resources would aid in the Bank's developmental efforts, Bank officials were not certain that those additional resources would best be applied through the regional system.

CONCLUSIONS

Our visits showed that the regional offices reflected the level of development in the cooperative community and the quality of the Bank's loan portfolio within the region. We also found that the regions had limited staff resources to aggressively carry

out those portions of the Bank's mission assigned to them, especially regarding cooperative development. Nevertheless, to cut costs, the Bank reduced the number of regional offices and staff which may further limit its ability to develop cooperatives nationwide. Thus, the regional system continues to change as the Bank Board and management try to balance the difficult tasks of developing loans which meet required standards and providing technical assistance and addressing other developmental needs of cooperatives.

BANK COMMENTS AND OUR EVALUATION

The Bank disagreed with our conclusion that curtailing the regional system may limit cooperative development efforts. However, we continue to believe that the closing or downgrading of five regional offices and terminating 23 regional positions (many of which were loan development officers with market development responsibilities) has limited the Bank's ability to carry out its mandates for cooperative development. In May 1983, after the reorganization, the Bank had only 14 professional staff in its regional system compared to 30 at the time we completed our review. The new regional structure created two, two-person branch offices expressly devoted to cooperative development. However, as of July 1983 (the time of the Bank comments) the Atlanta branch office was vacant and the Dallas branch office had only one person. Clearly, the present level of staffing limits the Bank's accessibility to both emerging and established cooperatives nationwide--a critical element in cooperative development.

The Bank also said that we underestimated the effect of the CCDC becoming operational without providing us any additional information supporting that position. The facts are that, as of the date of the Bank's comments, the new CCDC Board had not been seated, no Chief Operating Officer or other CCDC staff had been hired, and the Bank continued to perform title II activities for CCDC under the management reimbursement agreement. The establishment of CCDC in December 1982 has had no appreciable effect on development activities to date and may have only a limited effect in the future since the Bank will probably have to fund CCDC's development activities out of the Bank's resources in the near term. The Bank states that it can and will provide adequate support to CCDC, but as discussed in chapter 10 of this report, the Bank's ability to subsidize CCDC will depend on its ability to mature into a viable organization.

CHAPTER 6

QUESTIONS CONCERNING

THE ELECTION OF BANK BOARD MEMBERS

Our review of the process for electing nine Board members in January 1982 identified several questionable practices. Contrary to our review findings, the Board reported to the shareholders on May 26, 1982, that its review of issues surrounding the election process showed that the election was handled with integrity and completely in accordance with its election rules. Our review of the Board's report showed that it contained inaccurate, incomplete, and misleading statements. This chapter discusses the results of our review and includes certain additional information requested by the Chairman's office.

ELECTION ANNOUNCED

The Bank act, as amended August 13, 1981, provides that the Bank's shareholders will elect 12 of the 15 members of the Bank's Board of Directors. The other three Board members are to be appointed by the President of the United States. Prior to the August amendments, the act gave the shareholders authority to elect three directors and they did so in June 1981 (see p. 4). On September 9, 1981, the Board announced plans to elect the nine additional directors. The Board also announced the following key dates for the election.

--October 9 - Date for determining eligible voters. (The 189 shareholders of record as of that date were eligible to vote.)

--December 9 - Ballot mailed to shareholders.

--January 7 - Deadline for ballot postmarks.

--January 15 - Election results announced.

ALLEGATIONS OF IMPROPRIETIES IN THE ELECTION PROCESS

The Bank has been charged with improprieties in virtually every phase of the election process. These charges, both oral and written, have been made by former Bank employees, by The Co-op Bank Monitor, and by other Bank critics. The allegations made were as follows:

--The Bank established a weighted voting system that favored Bank supporters because senior Bank officials feared that cooperatives were attempting to increase their influence on the Bank through the election.

--The vote counting process was dishonest, and the Bank used the secret ballot procedure to cover up improprieties in vote counting.

--Attempts by cooperatives to buy stock were blocked by minor technical inadequacies in documents required for eligibility determinations.

In response to the allegations, the Board investigated the election process and reported its findings to the shareholders in a May 26, 1982, letter. The Board's report and our comments thereon, are discussed on page 60.

SPECIAL BOARD MEETING CHANGED ELECTION PROCEDURES

Several of the more controversial changes to the election procedures were made at a special meeting of the Board on October 26, 1981, which was over 2 weeks after the date of record to vote. One of the most significant changes was the adoption of a weighted voting procedure in lieu of the one-member, one-vote procedure used in the June 1981 election. Other changes were (1) a prohibition against former Bank employees serving on the Board within 2 years of the final date of their employment and (2) a prohibition against organizations such as churches or trade associations from becoming eligible cooperatives because their primary purpose is not to provide substantial economic benefits to members.

Weighted voting

The Bank Board established weighted voting even though the majority of Bank shareholders favored the one-member, one-vote principle. The Bank asked for comments from its shareholders on August 12, 1981, on how it could improve the election process. The Bank's analysis of the 34 responses to its letter, in a September 2, 1981, memorandum to the Board's ad hoc Election Review Committee, showed that 24 cooperatives favored the existing one-member, one-vote principle. The Bank also noted that two sharehol· ·s stated that the Bank should not change the voting weights until after the election. The Bank's file contained a September 8, 1981, summary of a telephone survey of the Bank's shareholders conducted by the Co-op Development and Assistance Project (see footnote on p. 10) on what the cooperatives wanted for the Board election. According to the survey, 83 of the 109 cooperatives contacted stated that the Bank should not change the one-member, one-vote principle and seven others said that the issue was critical and needed review, but not until after the election.

According to the minutes of the September 9, 1981, meeting, the Board extensively discussed the possibility of an attempted take-over of the Board by a small group of cooperatives and discussed weighted voting as a possible remedy. A member of the Board's Election Review Committee said that if a take-over attempt was indicated he would ask for a special meeting to deal with the problem. Subsequently, by letter dated September 10, 1981, the Bank notified the shareholders that the one-member, one-vote principle would apply in the January 1982 election.

At the October 15, 1981, Board meeting, the Secretary to the Board reported that over 100 applications for stock purchase had been received within the last 2 weeks and those that had been received by the October 9 date of record would become shareholders if they met the Bank's eligibility criteria. Subsequently, on October 20, 1981, the Chairman of the Bank Board called a special meeting for October 26, 1981. At that meeting a Board member reported that a pattern of shareholding had emerged that was clearly inconsistent with the Bank act and therefore a new voting formula was needed. Section 104 of the Bank act allows the Bank to establish more than one vote per shareholder based on the amount of business a cooperative does with the Bank, the number of members in the cooperative, and the amount of class B and class C stock held with limitations that will encourage investments in class C stock. The act also states that the Bank shall avoid voting control from becoming concentrated with larger, affluent or smaller, less affluent organizations or a disproportionately larger vote in one or more of the following groups of cooperatives: housing, low income, and consumer goods and services.

A weighted voting formula was introduced and voted on at the October 26, 1981, meeting. Although the Board's vote on the weighted voting formula was 10 to 1 in favor, two of the three Board members elected in June 1981, who were also members of the Election Review Committee, expressed concern over changing the voting rules in the middle of the election. The Board member who voted against the formula noted that although the weighted voting system was a fair one, it was undemocratic to make the change without outside input.

On October 30, 1981, the Board notified the shareholders of the new voting formula which provided that all nonborrowing shareholders (class C) receive one vote and all borrowing shareholders (class B) receive five votes plus additional votes based on loan size and type and the number of members in the cooperative. The Bank noted that the voting formula gives larger, affluent cooperatives 269 votes and smaller, less affluent cooperatives 289 votes. It said that housing cooperatives and low-income cooperatives each would have 40 percent of the vote and cooperatives doing business with the Bank had a greater representation than those that do not.

The Bank furnished us documentation to support its determination that the vote was balanced in terms of the cooperative's affluence and size for cooperatives that do business with the Bank. The data furnished was reconstructed for us by the Bank's Office of General Counsel because the Bank was not able to find the original documents. The Bank based its determination of affluence on whether the cooperative met the Bank's low-income definition and based the determination of size on whether the cooperative had 5,000 members or less. Our comparison of this documentation with other Bank data from the Office of General Counsel on the cooperatives' size and affluence showed that its classification of cooperatives was generally correct.

As discussed, the new weighted voting formula did, in fact, maintain a balance between the larger, affluent and smaller, less affluent cooperatives and between selected cooperative groups, as required by section 104 of the act. However, we observed that:

--The formula adopted may not satisfy the provision in the act that the formula should encourage investments in class C stock. In this regard, class B shareholders were assigned 841 of the 935 total assigned votes, or about 90 percent. Moreover, the two class B shareholders with the largest number of votes had a combined weight of 92 votes compared to a combined voting weight of 94 votes for all 94 class C nonborrowing shareholders.

--The 26 cooperatives with the largest voting weights, that were eligible to vote in the election, could have elected all of their candidates if they had voted as a block regardless of how the other 163 shareholders eligible to participate in the election voted--a situation that the Bank sought to avoid with its new formula.

Other changes at the special Board meeting

The Bank added a restriction on the qualifications for Board membership by prohibiting former Bank employees from serving on the Board until 2 years after their final employment date. Prior to the change there was no prohibition against former Bank employees serving on the Board. The transcripts of the Board meeting at which this change was approved do not indicate the reason for the change. The Executive Vice President told us that the Board believed that a former employee would have an unfair advantage over other candidates because of his relationship with the shareholders. This change was made after the Board announced its nominees but before the shareholder petition nominee process was completed.

Another change made at the October 26, 1981, special Board meeting, was a Board resolution that prohibits organizations whose primary purpose is not to provide substantial economic benefits to its members from becoming Bank shareholders. This meant that organizations such as trade associations, churches, and alumni associations could not become shareholders. The Secretary to the Board said that the purpose of this resolution was to clarify the Board's position that these are not eligible cooperatives under the Bank's statute. As a result of this resolution, the Bank rejected at least two cooperatives applying to become shareholders because they did not comply with the resolution. We also found, however, that for two shareholders that were permitted to vote in the election, the Bank had determined that they were possibly ineligible under this new resolution. After the election, the Bank notified one of these cooperatives that it was no longer eligible and refunded the purchase price of its stock. The Bank's records do not indicate that further action was taken on the other cooperative.

SELECTION OF BOARD NOMINEES

According to the Bank's election rules, candidates can be placed on the ballot by a majority vote of the Board's nominating committee. Also, candidates can be placed on the ballot, if they provide documentation showing they have the support of at least 15 percent of the eligible shareholders of record at the time the election was announced. The act provides that each nominee for a directorship of a particular class shall have at least 3-years' experience as a director or senior officer of that class of cooperative.

The ballot for the January 1982 election listed 20 candidates, 4 in each of the five classes of cooperatives identified in the act (see app. III). Seventeen of the candidates were selected by the nominating committee and 3 by stockholder petitions.

Not all of the candidates selected by the nominating committee nor the petition candidates qualified to be placed on the ballot. The nominating committee originally selected 21 candidates, but as noted above only 17 of these candidates were placed on the ballot. Of the four Board nominees that were not on the ballot, three nominees lacked the 3-years' experience with a qualified cooperative and one nominee withdrew from the election.

The Bank's petition nominee log shows that the shareholders nominated 11 candidates. Our analysis of the individual nominee files showed one nominee withdrew her name and seven others were eliminated for the following reasons:

--One nominee lacked the required 3-years' experience with an eligible cooperative.

--One nominee had worked for the Bank within the last 2 years.

--Five nominees did not receive the required endorsement from 15 percent of the Bank's shareholders.

Our review of the nominee's eligibility files showed that the Bank was generally consistent in its treatment of nominees. The Board recognized in its May 26, 1982, report to the shareholders that confusion existed regarding proper endorsement of certifications of the petition candidates. It stated that every petition candidate with the required number of signatures was qualified to appear on the ballot if he or she met the requirement for cooperative service. Our review of the nominee eligibility files showed that the above statement was accurate. However, the report did not disclose that one petition candidate was disqualified because of the Board's 2-year rule concerning former employees. Instead, the report said that two petition nominated candidates were disqualified because they did not meet the requirement for 3 years of service in an eligible cooperative.

SHAREHOLDERS' ELIGIBILITY CRITERIA WERE TIGHTENED

During the month between announcing the January 1982 election and the record date for shareholders to vote in the election, the Bank tightened its eligibility criteria for purchasing class C stock--stock issued to cooperatives eligible to borrow from the Bank. This action prevented many applicants from becoming approved shareholders by October 9, 1981, and accordingly they could not vote in the election.

Eligibility criteria tightened

On September 10, 1981, 1 day after the Bank announced the election, the Bank's then Acting General Counsel notified the Bank staff that cooperatives interested in purchasing class C stock were no longer permitted to self-certify their eligibility for the purchase of such stock. Instead, he said that a formal eligibility determination would be required and cooperatives applying for stock purchases were to submit the following information:

--Bylaws certified by the corporate secretary.

--Articles of incorporation certified by the appropriate secretary of state.

--A brief operating history and any other relevant information that might assist in the Bank's eligibility determination. The former Acting General Counsel also prepared pro-forma Board resolutions on open membership and distribution of net savings that were to be completed in the event that the cooperative's bylaws did not reflect compliance with the statute.

Previously, a cooperative's secretary was permitted to submit a certified statement that the cooperative, among other matters,

--was a legally incorporated entity operating on a not-for-profit basis for the benefit of its members;

--made membership available to all persons who could make use of the service and are willing to accept the responsibility of membership;

--restricted voting control to members on a one-member, one-vote basis; and

--distributed net savings to members as patronage dividends or among other purposes retained them for expansion or reduction of charges.

The self-certification form also stated that this eligibility determination was solely for purposes of purchasing stock and that in the event the cooperative applied for assistance, a more thorough eligibility determination would be required.

In explaining the rationale for the stricter certification process, the then Acting General Counsel in a September 10, 1981, memorandum to the Bank staff stated that it was to protect the Bank from issuing stock to shell (ineligible) cooperatives. Also, he said that it would eliminate the potential embarrassment caused when stock is sold on the basis of self-certification and subsequent information shows the cooperative to be ineligible.

Two former Assistant General Counsels, who were responsible for processing stock purchase applications during the period between the announcement of the January 1982 election and the date of record for the election, told us that they had seen no evidence of shell or inactive cooperatives trying to buy Bank stock. They believed that the discontinuation of the self-certification method of stock purchase was a defensive measure by senior Bank officials against what they believed was an organized attempt to take control of the Bank through the election.

The Bank tightened the eligibility procedures further sometime during the 30 days between the elimination of the self-certification procedure on September 10, 1981, and the October 9, 1981, date of record. The Bank started requiring shareholder applicants to submit a recent (within the last year) certification from their appropriate secretary of state that the articles of incorporation were current and the cooperative was in good standing. The two former Assistant General Counsels told us that previously the procedure for ascertaining that a cooperative was in good standing was for a Bank employee to telephone the secretary of state's office and obtain this information orally. They said, however, that the Bank discontinued this telephone verification procedure by oral instructions from senior management without explaining why the change was necessary. One of these former officials said that an oral statement from the secretary of state's office that the cooperative's articles of incorporation were current and it was in good standing was as good for the Bank's purposes as a written statement.

In response to our question as to why the September 10, 1981, memorandum to the Bank staff did not call for documentation that the cooperative was currently in good standing, the former Acting General Counsel said that it was an oversight. In addition, the former General Counsel and former officials of his office were unable to document or remember exactly when the Bank instituted the requirement for written documentation from the secretary of state. The former Acting General Counsel told us that he advised the former Bank President that the Board should make a decision on whether the Bank should require a documented current certification and also whether the Bank should consider failure to comply with this requirement a substantive or a technical violation of the eligibility procedures.

In commenting further on changes to the Bank's eligibility criteria, the former Acting General Counsel told us that the different environments in which the Bank was operating impacted its eligibility criteria. He explained that up to the announcement of the January 1982 election, the Bank wanted to sell as

much stock as possible to assist in its fight against the Reagan administration's effort to abolish it and therefore the Bank had relaxed eligibility requirements. After the act was amended to give Bank shareholders the authority to elect 12 of the 15 Board members, the Bank was concerned that certain cooperatives were attempting to gain control of the Bank through the election and therefore, the Bank tightened its eligibility criteria. He also told us that until the announcement of the January 1982 election he was under constant pressure from the former Bank President and the loan staff to relax eligibility criteria.

Changed procedures resulted in many shareholder applications not being approved

According to Bank records, approximately 175 cooperatives applied to purchase class C stock between September 9, 1981, the date the Bank officially announced the election, and October 9, 1981, the date of record for shareholders to vote in the election. Of these, 62 were determined to be eligible as of the October 9, 1981, cutoff date. The Bank did not approve the remaining approximately 113 applicants. The Office of General Counsel reported to the Board Chairman that there were basically four items missing in the majority of applications that precluded positive eligibility determinations: (1) a recent (within the last year) certification from the secretaries of state showing that the articles of incorporation submitted were current and that the corporation was in good standing, (2) a certification from the corporate secretary showing that the bylaws submitted were correct and current, (3) completion of a Board resolution on open membership adopted by the cooperative's board, and (4) completion of a Board resolution on distribution of net savings adopted by the cooperative's board.

Our review of Bank records summarizing the reasons precluding the approval of these applications showed that 10 applicants were denied the right to become shareholders because of a failure to submit a certificate of good standing and 6 applicants were denied the right to become shareholders because of a failure to submit a good standing certificate and a certification of its bylaws. Fifty applicants were denied the right to become shareholders because of a combination of two or more of the four items. These four deficiencies were characterized by the Bank's Office of General Counsel at the time as technical problems only. The remaining 47 applications contained other problems which were characterized as major or complex problems such as (1) articles of incorporation or bylaws were not provided, (2) bylaws were not adopted, and (3) cooperative did not have a one-member, one-vote principle.

Bank eligibility criteria were inconsistently applied

We found that the Bank did not consistently apply its eligibility procedures to (1) shareholder applications received during the period between the announcement of the election and the

date of record to vote in the election and (2) shareholders who had been approved previously under self-certification procedures.

As noted above, only 62 of the 175 cooperatives that had applied for the purchase of class C stock between September 9 and October 9, 1981, were declared eligible. Our review of the Bank's eligibility files for these 62 shareholders showed that 23 of these shareholders had not submitted certified bylaws and/or certifications from the secretary of state showing that the articles of incorporation were current and that the cooperative was in good standing--the very same reasons used to preclude other cooperatives from becoming shareholders in time to vote in the 1982 election.

Our review of the files also showed that 23 shareholders, which had been approved under the prior self-certification procedure, were also permitted to vote in the January 1982 election. As noted above, these shareholders had not been required to submit any documentation to the Bank other than a standard form saying that they met the Bank's eligibility requirements.

On September 17, 1981, and again on December 11, 1981, the Bank notified all self-certified shareholders that the self-certification procedure was rescinded and they must submit information needed for the Bank to make a formal eligibility determination. In the second notice to these shareholders, the Bank stated that their voting rights may be put in jeopardy if the requested material was not submitted.

We understand the Bank's concerns that led to the elimination of the self-certification procedure, but we find it difficult to understand why the Bank permitted these shareholders to vote when they did not comply with repeated requests for information needed to make a formal eligibility determination. During the same time period, the Bank was rejecting stock purchase applications for noncompliance with the eligibility procedures. An example of the problem created by inconsistent treatment of stock purchase applications is the case of one shareholder that had self-certified and was eligible to vote in the election even though the Bank's Office of General Counsel previously questioned the cooperative's eligibility during a review of a prior loan application and the file contained no evidence that the questions raised were ever resolved.

The Bank's Executive Vice President told us that these shareholders were permitted to vote because the Bank believed that it would be unfair to apply rules retroactively and deprive shareholders of their voting rights.

DEFICIENCIES IN THE BALLOTING PROCESS

Our review of the Bank's 1982 election rules and all election documents--resolutions, certifications, ballots, and tally sheets--and other pertinent Bank files showed the following deficiencies.

--Five ballots were disqualified because an officer other than the secretary certified election documents. The election rules allow for other officers to certify when authorized to do so by the cooperative. The Board's decision to disqualify these ballots changed the election outcome.

--Five official election envelopes were opened prior to the official opening date without any explanation of the circumstances leading to the premature opening. A sealed envelope was a voter's only safeguard that its completed ballot was used in the tally.

--The propriety of another ballot was not questioned even though it was signed by an officer of the cooperative other than the secretary.

Our review also showed that one ballot was disqualified because the required board resolution was missing, but we discovered this resolution in another file within the Bank.

Voting procedures

On December 9, 1981, the Bank mailed the 189 shareholders of record a packet of material for use in their participation in the 1982 election. In addition to the official ballot, the election package included:

--A pro-forma resolution for the cooperative's board of directors to designate the cooperative's authorized voting representative.

--A pro-forma certification form for use by the designated voting representation to certify that he or she voted and for the corporate secretary or other authorized official to certify that the designated representative was the person who voted.

--Nominees' biographies and nominee comments concerning the role of the Bank.

--A pre-addressed, postage-paid envelope for returning the ballot and required certifications to the Bank.

--A gray envelope for sealing the official ballot.

--A final shareholder list showing the number of votes to which each shareholder was entitled.

To ensure a secret election, which the Board determined would be conducted, the Bank instructed the shareholders to seal their completed ballot in the gray envelope marked "official ballot" and return it and the required certification to the Bank in the pre-addressed, postage-paid envelope.

On January 13, 1982, the Bank had Touche Ross & Co., a public accounting firm, assist it in opening the ballots and tallying the votes. Touche Ross discussed the election rules, the tallying process, questionable ballots and their disposition, and the election results in a January 15, 1982, letter to the Board's secretary. Touche Ross said that it understood for a ballot to be valid

--the cooperative secretary should have certified which representative was designated to cast the cooperative's ballot by resolution of its board of directors;

--the designated representative should have completed the ballot and signed and dated the "stockholder representative certification" form;

--on the "certification of the corporate secretary," the corporate secretary should have certified the designated representative's signature;

--the resolution, certification, and the ballot should have been postmarked or delivered to the Bank no later than January 7, 1982; and

--no more than nine candidates should have been voted for on each ballot and no more candidates should have been voted for in each class than as stated in the instructions on the ballot. (See app. III for a copy of the sample ballot.)

Moreover, Touche Ross said that the following steps were followed in the vote tallying process:

--The Bank's former General Counsel opened those envelopes postmarked prior to January 8, 1982. Most contained a certification, a resolution, and a sealed envelope containing the ballot. He then removed the resolution and the certification. In the cases where the cooperative resolution was not enclosed, a search was made through resolutions which had been previously received. If both the resolution and the certification were not in the envelope, the inner envelope was opened to remove any documents other than the ballot. No ballot was reviewed at this time.

--The resolution and certification were then checked according to the rules stipulated above to determine the validity of the ballot, and stapled to the outside envelope.

--For all ballots deemed to be valid by the former General Counsel, he assigned a sequential number, the administrative aide looked up the appropriate weighting factor for the vote on the stockholder list; the former General Counsel listed the appropriate sequential number, and the

weighting factor on both the voting list and the ballot envelope, and he listed the cooperative's name on the voting list.

--Each ballot envelope was placed in a pile away from the table.

--After all valid ballots were numbered, the certifications, the resolutions, and the voting list were removed from the area and the ballot envelopes were placed on the table.

--The Secretary to the Board[1] entered the room for the counting of the votes.

--Each ballot envelope was opened and the ballot stapled to its envelope by the administrative aide.

--A list was prepared by the Touche Ross representative of the cooperative number, the weighting factor and the weighted number of votes cast for each candidate, as this information was read aloud by the former General Counsel.

After all ballot[2] that were deemed to be valid by the Board's Secretary were tallied, Touche Ross said that the ballots, certifications, resolutions, sealed envelopes postmarked after January 7, 1982, unused ballots, and other related election material were given to them. Touche Ross independently rechecked the certifications, resolutions, postmarks on outer envelopes, and the ballots. They questioned the propriety of including 27 ballots in the official tally.

Our review of the election documents indicated that the propriety of 20 of the 27 ballots had been questioned jointly by Touche Ross and the Bank's staff and only Touche Ross had questioned the propriety of the other seven ballots. The record shows that seven ballots were sequentially numbered, apparently in the order reviewed. As noted above, this was the procedure followed when the Bank's former General Counsel deemed the ballot valid. The other 20 ballots were either not assigned a sequential number or were otherwise treated differently from the valid ballots. In this regard (1) 12 ballots had not been assigned a sequential number by the former General Counsel, (2) 3 ballots, on which more than nine candidates were marked, were not recorded on the tally sheet, and (3) 5 ballots were assigned the last five sequential numbers in the series and also were not recorded on the tally sheet.

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[1]The Bank's Executive Vice President was also the Secretary to the Board at the time of the election.

[2]Of the 189 shareholders of record, 128 cast ballots that were included in the final count. These 128 ballots had a weighted vote of 755.

On January 14, 1982--the day after the ballots were opened--the Board reviewed the 27 ballots that had been identified as questionable. At the time, the Board consisted of only four members[3]--the three members elected in June 1981 and one who had been appointed by the President of the United States. The Chairman and one member were present at the Board meeting and one member participated via a conference call. The Executive Vice President and one Board member told us that the Board did not know whose ballots were being questioned or what effect their decisions would have on the election outcome. The Board decided to disqualify 20 of the 27 ballots. The number of ballots disqualified and the reasons follow.

Number of ballots	Reason for disqualification
4	Postmarked after January 7, 1982.
4	Resolution missing.
1	Both resolution and certification missing.
1	Certification missing.
2	Certification unsigned.
3	Voted for more than nine candidates.
5	An officer of the cooperative other than the secretary signed certification and/or resolution.

These were the same 20 ballots that the Bank's former General Counsel and the Board's Secretary had questioned.

The Board decided not to disqualify the remaining seven ballots questioned by Touche Ross. The number of ballots and the reason these ballots were questioned follow.

Number of ballots	Reason for questioning
1	Signature of the secretary affixed on the certification by the designated representative.
2	Signatures on the certification of the designated representative and the secretary appeared to be in the same handwriting.
1	Secretary certified that he himself completed the official ballot rather than the designated representative.
1	Signatures of the designated representative and the secretary affixed on the certification by a typewriter.
1	Assistant secretary signed the certification and resolution.
1	Ballot received in one envelope and resolution and certification received in a separate envelope.

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[3]In accordance with the Bank act, as amended, the other nine directors left the Board on January 1, 1982.

The Bank did not prepare written documentation explaining and/or justifying the Board's decisions on these 27 ballots. Therefore, we questioned separately the Bank's former General Counsel, its Secretary to the Board, and the three Board members who had participated in the Board's decisions. We received conflicting as well as incomplete information.

Deficiencies we identified

Our review of the election rules, election documents, and other pertinent information disclosed several deficiencies in the election process. We discuss our findings below.

Ballots disqualified for noncompliance with election rules

As noted previously, the Board disqualified five ballots because an officer of the cooperative other than the secretary had signed the resolution and/or certification. According to the Touche Ross January 15, 1982, letter, Touche Ross understood that only the secretary was authorized to certify the document. This position was also communicated to the cooperatives in the letter signed by the Board's secretary, transmitting the election package to them. However, the official election rules adopted by the Board on November 2, 1981, and sent to each shareholder state:

> ". . . In order to be counted . . . each vote by a Stockholder must be cast on the official ballot form issued by the Bank, and must be certified by the corporate secretary or other official of the stockholder who is authorized to certify its corporate documents. . . ." (Underscore supplied.)

The Board's decision to disqualify these five ballots resulted in one winning candidate and one losing candidate switching places.

The former General Counsel told us that he was aware of the official election rule, but these ballots were not included because the Board told the Bank's staff that it wanted to consider only what was "on the table before them" in determining the validity of ballots. He said that the information was not available for him to determine with certainty whether the officers who had signed the documents were authorized to do so. In a March 23, 1983, letter to us, the former General Counsel stated that under the rules the voter had the obligation and burden to supply the Bank with documentation that an official other than the secretary was authorized to certify corporate documents. The letter stated further that the Bank was under no obligation to inquire of the voter whether such authorization had been given.

The Secretary to the Board said that he did not recall any real disagreement on the questionable ballots. He said that apparently no one realized that the former General Counsel had made the instructions accompanying the ballot more restrictive than the voting rules.

Each Board member told us that the Board's position was to qualify as many of the questionable ballots as possible. None of them could recall, however, the detailed circumstances surrounding the decision to disqualify these five ballots. Two of the three Board members initially commented that these ballots were counted and one of the two cited the allowance of these ballots as an example demonstrating the Board's position of qualifying as many ballots as possible. After we pointed out that the Board had disqualified these ballots, one member said that he was recalling only his position to allow them to count and the other member presented a scenario expressing a position that the Board had to be concerned that the vote expressed the cooperative's desires and not just the desires of one of the cooperative's officers.

Another factor which confuses the circumstances surrounding the decision to disqualify these five ballots is the apparent inconsistency in the Board's decision not to disqualify certain other ballots questioned by Touche Ross. In these instances, the Board decided not to disqualify (1) one ballot where the signature of the secretary was affixed on the pro-forma certification by the person whose actions were being certified and (2) two ballots where the signature of the designated voting representative and the secretary appeared to be in the same handwriting. The Board's decision to accept those three ballots did not change the election outcome.

The official election rules adopted pursuant to section 102 of the act, as amended, provided that an election notice shall be sent to shareholders of record 30 days prior to the election. The notice was to include the official ballot and all other information needed by shareholders to participate in the election. The notice sent to shareholders said that all material necessary for shareholders to participate in the election was enclosed. We observed that shareholders were not provided any form to document, nor were they told to document, that an official other than the secretary was permitted to certify election materials. By being silent on this matter, we believe that the election rules could reasonably be interpreted by the shareholders that they had no obligation to notify the Bank who was authorized to certify election material. Other observations we made follow:

--The officers that signed the documents clearly identified themselves by title.

--In each case, the officer who signed the document was a person different than the person the cooperative had designated to vote for it and they had certified that they had completed the ballot.

--The five cooperatives collectively had 26 votes.

By agreement with the Committee Chairman's office, we did not follow up with the cooperatives to ascertain whether the officers who had signed the documents had the authority to do so. In order to make this determination, we would have had to break the secrecy pledge given to the cooperatives by the Board. In spite of this,

we observed information in the Bank's files showing that one of the five cooperatives had notified the Bank prior to the election that it did not have a secretary. For another, the officer that signed the document had indicated that the secretary was unavailable.

Ballots opened prior to official date

The Bank's election rules did not describe the procedure for handling ballots from the time they were received at the Bank until they were to be opened, but according to the Bank's former General Counsel and one Board member, the pre-addressed envelope to be used by shareholders for returning ballots and related election documents to the Bank were to be delivered unopened to the General Counsel's office for safekeeping until the official election day. Our review of the voting material in Touche Ross' possession showed that six envelopes had been opened prior to that day. Our review also showed that five of these ballots had been returned to the Bank in the official election envelopes and one had been returned in an unofficial envelope which could not be identified as containing election material. Attached to the one unofficial envelope was a memorandum signed by a Bank employee stating that the envelope had been opened by mistake and that its contents were not removed. For the five official envelopes that were opened, there was no explanation as to (1) who opened the envelopes and (2) the circumstances leading to the premature openings. One envelope had an unsigned note on it which stated that it was opened in error.

A sealed envelope was the only safeguard shareholders had that the ballot they filled out and mailed to the Bank was the one that was used in the election tally. Once the seal was broken a ballot could have been replaced undetected because the official ballot contained no identifying marks. We observed that these five cooperatives collectively had 21 votes which was enough votes to change the election outcome. We do not know why the envelopes were opened or whether the ballots were altered. Accordingly, the impact this occurence had on the election outcome is uncertain.

Ballot not questioned

During our review of the election documents, we noted that the propriety of one ballot was not questioned even though an officer other than the secretary had signed the resolution and certification. Five other ballots which had been similarly signed by an officer other than the secretary had been disqualified. In response to our inquiry as to why the propriety of this ballot was not questioned, the Bank's former General Counsel said he could not recall. He said that prior to the election he had received calls from a few cooperatives requesting election rule clarifications and he may have been told that this officer performed the secretary's duties for the cooperative. Also, he said that without such an explanation, the ballot should have been disqualified. We observed that this ballot had one vote and the exclusion of that vote would not have changed the election outcome.

Ballots disqualified for missing documents

Another matter we observed relates to one of the four ballots the Board disqualified because the required resolution from the cooperative designating the person authorized to vote in the Bank's election was missing. In reviewing the Bank's eligibility files, we located a copy of the required resolution. While we cannot determine whether the Bank had the document at the time of the election, we observed that the Bank's election rules did not require a cooperative to return the resolution to the Bank in the pre-addressed election envelope. The Touche Ross letter said that other cooperatives returned the resolution to the Bank under separate cover. In those cases where a resolution was not enclosed in the pre-addressed election envelope, a search was made through resolutions that were previously received. Although the cooperative may have complied with this election requirement and its vote was disqualified because of a filing error by a Bank employee, the cooperative was entitled to only one vote and its disqualification did not change the election outcome.

BOARD REPORT ON THE ELECTION ISSUES WAS INACCURATE

In response to allegations of improprieties, the Board investigated the election process and reported its findings to the shareholders in a May 26, 1982, letter. The Board concluded that the election process was handled with integrity and completely in accordance with the election rules. As discussed above, our review showed that the election process contained a number of inconsistencies and other deficiencies. In addition, our review showed that the report itself contained inaccurate, incomplete, or misleading statements. We discuss the more significant of these below.

The Board's report described Touche Ross' involvement in the vote tallying process and stated that Touche Ross ". . . completed its count and certified the results in a letter to the Board." Our review of the Touche Ross letter showed no evidence of any such certification. A Touche Ross official told us that Touche Ross did not certify the election results and explained that before Touche Ross would certify the results of any election it would need to completely control the election process.

The Board's report stated that

> "every effort, from the beginning, was made to qualify eligible cooperatives and candidates and to count eligible votes, consistent with the need to follow a regular and fair process in the conduct of the election."

We found that, as discussed on page 49, rather than make every effort to qualify eligible cooperatives the Bank eliminated its procedures allowing cooperatives to self-certify that they met the Bank's eligibility requirements. Furthermore, the Bank discontinued its practice of telephone verification that the

cooperative is in good standing with the state government offices and required the applicants to submit a written certification of good standing from the state offices.

According to the Board's report, 94 percent (62 of 66) of the cooperatives that submitted applications to purchase stock by the record date were able to participate in the election. As discussed on page 51, the Bank did not approve approximately 113 applications out of a total of 175 submitted to purchase stock by the record date which represents an approval rate of about 35 percent rather than 94 percent cited in the Board's letter.

The report stated that no official envelope was opened prior to the day the votes were counted. As noted previously on page 59, our review showed that five official envelopes had been opened prior to the day the ballots were counted.

In light of the problems we noted in the Board's report and the statement in the report that the Board conducted a complete and thorough review of the issues surrounding the election, we met with the Board's Chairman to discuss the report. The Chairman said that the Board did not conduct an independent review of the election process but instead relied primarily on briefings and explanations by the Bank staff on how the election was conducted. The Chairman also stated that the Board relied on the Bank's staff to draft the Board's report.

CONCLUSIONS

The Bank's 1982 election is clouded by the inconsistent application of, or changes in, its procedures. The Bank discontinued its policy to allow cooperatives applying for the purchase of Bank stock to self-certify that they met the Bank's eligibility requirements. This change, in conjunction with other more stringent Bank eligibility practices, resulted in many shareholder applicants being denied the opportunity to participate in the 1982 election. Other cooperatives that were allowed to participate in the election were not required to meet the more stringent requirements because (1) the Bank was not consistent in the application of its criteria or (2) they were declared eligible during a time when the Bank wanted to increase its number of shareholders and apparently was more lenient in the application of its criteria.

The Board decisions to disqualify five ballots because an officer other than the secretary signed election documents appeared inconsistent with its decision to allow other questionable ballots to count. The basis for the Board's decision was not documented and our questioning of both Board members and Bank officials involved in making this decision produced conflicting as well as incomplete information. The Board's decision to disqualify the five ballots changed the election outcome.

Five official election envelopes were opened prematurely and there was no explanation as to who opened the envelopes or why they were opened. A sealed envelope was a shareholder's only safeguard that its completed ballot was the one used in the

tally. We do not know why the envelopes were opened or whether the ballots were altered. Accordingly, the impact of this occurence on the election outcome is uncertain.

The Board's report on its review of issues concerning the election process has several inaccurate, incomplete, and misleading statements. The Board concluded that the election process was handled with integrity. However, in view of our findings, we believe that the Bank should reevaluate the election process and the ramification of the Board's decision and decide what corrective action, if any, should be taken.

Concerning future elections, we believe that the Board should fully document the basis for changes in the election process and take steps to ensure that its election policies and procedures are applied consistently to all cooperatives. Further, we believe that the Bank should follow its election rules and, in particular, provide its shareholders all the material needed to vote. Also, we believe that to improve the credibility of future elections, the Board should contract with an independent firm to control the entire voting process.

BANK COMMENTS AND OUR EVALUATION

The Bank said that the Board wants to avoid similar questions in its 1984 election and will issue election procedures well in advance of the next annual meeting. Although the Bank's comments did not state what changes would be made, the Board's Chairman testified on June 14, 1983, before the Chairman, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, House Committee on Banking, Finance and Urban Affairs, that future elections should be handled by, and not merely with the assistance of, a third party, such as an accounting firm. The Bank disagreed with and/or challenged several of our findings.

Eligibility requirements

The Bank stated that we believe that it was improper for the Bank to establish more stringent eligibility requirements for the purchase of voting stock after it announced the election. It also stated that we did not give sufficient weight to the Bank's decision not to disqualify any shareholder that had been previously deemed eligible under the self-certification procedure even though the Bank twice requested such shareholders to document their eligibility.

We did not conclude that the Bank's actions were improper, but rather we disclosed that the establishment of more stringent eligibility requirements just prior to the election prevented many applicants from becoming eligible to vote in the election. Also, contrary to the Bank's statement that we did not give sufficient weight to the Bank's decision not to disqualify the self-certified shareholders, we included in the draft report the Executive Vice President's statement that these shareholders were permitted to vote because the Bank believed that it would have been unfair to apply the rules retroactively and deprive shareholders of their

voting rights. The Bank restated this position to support its claim that we did not give sufficient weight to its decision.

The Bank stated that the other change we criticized was the requirement that a confirmation from the appropriate secretary of state that a cooperative was certified to do business must be written instead of oral. According to the Bank, this change was not inconsistent with the expressed intent of the Board or a breach of proper election procedure.

We did not criticize the change in procedure, but rather we pointed out that the change occurred shortly before the cutoff date by which applications had to be approved for a shareholder to vote in the election. We also pointed out that as a result of this change many shareholder applicants were not approved by the record date and, accordingly were denied the opportunity to vote in the election. Regarding the Bank's comment that this action did not seem inconsistent with the expressed intent of the Board, we were not able to find any record of where the Board ever discussed this requirement.

The Bank acknowledged that a number of new shareholders that did obtain certification had certain minor deficiencies. It stated that its only explanation ". . . is that attorneys who were then members of the General Counsel's staff did not execute properly--either intentionally or accidentally--their responsibilities to apply the membership criteria."

While the Bank's eligibility files do not show why shareholders were approved without meeting all criteria, they show that the former General Counsel reviewed all eligibility determinations of his predecessor before the determinations were finalized. The former General Counsel told us that he did this work at the direction of the former President who reviewed and concurred in each decision.

Disqualified ballots

The Bank stated that it was our opinion that the Board should not have disqualified the five ballots because the secretary did not sign the election documents. Our report states that the Board disqualified five ballots because an officer other than the secretary certified the election documents. The report correctly notes that the Bank's election rules permit other officers to sign when authorized by the cooperative and that the decision appeared inconsistent with decisions to qualify certain other ballots. We did not conclude, however, that the ballots should have been qualified.

The Bank stated that the disagreement as to what ballots should have been disqualified only arises because of a minor discrepancy between the election rules and the ballot instructions. The election rules state that any officer of a cooperative who is authorized to certify its corporate documents could certify an election ballot. The ballot instructions expressly directed voters to have these documents signed by the corporate secretary.

We believe that the Bank may have mischaracterized the significance of the discrepancy. If it contributed to the ballots being disqualified, then it may have resulted in the five shareholders being denied participation in the election. Furthermore, if the ballots of the shareholders were counted, one winning candidate and one losing candidate would have changed places.

The Bank stated that we concluded that the exclusion of these ballots affected the outcome of the election but at the same time questioned the inclusion of other ballots. It then questions the impact different Board decisions would have had on the elections outcome. The Bank stated:

> "All of this speculation on various scenarios ignores the most critical point: GAO has not disclosed any evidence that the Board knew (i) whose ballots were being raised for decision, (ii) how many votes were involved or (iii) what effect various decisions would have had."

We did not question the inclusion of other ballots, but rather disclosed that the Board's decisions on those ballots appeared inconsistent with its decision on the five disqualified ballots. Also, we disagree with the Bank's inference that we ignored what it believes to be the most critical point. We disclosed that the Executive Vice President and one Board member told us that they did not know the identity of the cooperatives whose ballots were being questioned or how many votes were involved. (See p. 56.)

Opened envelopes

The Bank commented that if it is true that five election envelopes were opened before the election date with no indication as to who opened them, then this was news to the Bank. It stated that it was aware that three ballots were inadvertently opened by Bank mailroom and clerical staff prior to the election date and these ballots were so marked. Also, it stated that the workpapers may indicate additional envelopes were opened, but there is no way to tell from the workpapers whether it was an outer or inner envelope. According to the Bank, if there was an opportunity for mischief, the accounting firm (Touche Ross) presumably would have flagged the matter at the time.

As stated on page 59 of this report, our review showed that six envelopes were opened prior to the official election day--five in official election envelopes and one in an unofficial envelope--and only the unofficial envelope was properly marked as to the circumstances of its opening. The Bank is correct in its statement that the Touche Ross workpaper does not show whether an outer or inner envelope was opened. However, the Touche Ross representative who prepared the workpapers in question, told us that the outer envelopes were being tracked. In our opinion, there was no apparent reason to identify whether the inner envelope was opened or sealed because as the Bank recognized in its comments, an unsealed inner envelope could simply mean that the shareholder

failed to seal the envelope. On the other hand, a sealed outer envelope was a shareholder's only safeguard that the ballot it prepared was the one counted in the official tally.

Regarding the absence of a comment by Touche Ross in its January 15, 1982, report to the Bank on the election, Touche Ross told us that they did not question the propriety of the matter because their experience has shown that it is not unusual for envelopes to be received unsealed or opened in error.

Shareholder report

The Bank stated that our analysis of the Board's report is quite unfair. It stated that there was no attempt to mislead the shareholders but admitted that perhaps the Bank could have chosen a better word than "certify" to describe Touche Ross' role in the election. It said the Bank had intended to communicate that Touche Ross certified the tally results.

Although the Board may not have intentionally attempted to mislead its shareholders, the statement in its report that "Touche Ross then completed its count and certified the results . . ." conveyed broader meaning to both Touche Ross and us than the Bank itself acknowledged was intended. As noted on page 60, Touche Ross' letter did not make any certification. Moreover, a Touche Ross official said that Touche Ross did not certify the election results and before it would do so it would need to completely control the election process.

The Bank stated that whether every effort was made to qualify eligible cooperatives was strictly a judgment call. As we have already stated on page 49, the Bank tightened its shareholder eligibility criteria after the election was announced and as a result many cooperatives were denied the opportunity to vote in the election. For example, cooperatives were refused stock because they did not submit written documentation from the state government that they were in good standing. Before this change, the Bank allowed its staff to get this information orally from the appropriate state office.

The Bank stated that regarding the number of cooperatives not approved to vote in the election, the Board was not deliberately hiding any relevant information but used a different base for measurement than ours. We did not attempt to determine whether the Bank was deliberately hiding relevant information. We simply noted that rather than not approving four applicants as stated in the Board's report, the Bank records showed that approximately 113 applications were not approved.

Regarding the Board's statement that no official envelope had been opened prematurely, the Bank stated that it did not know then (at the time of the Board's report) and does not know now that an outer envelope had been opened prematurely. The Bank's comments are contradictory on this point. On one page of its comments, the Bank stated, "The Bank had understood that there were three

ballots inadvertently opened by Bank mailroom and clerical staff prior to the official election date and that they were so marked." On another page, it stated, "Of course, the report said that no official envelope had been opened prematurely because the Bank did not know then and does not know now that an 'outer' envelope had been opened prematurely." (See pp. 99 and 100.)

CHAPTER 7

NONCOMPLIANCE WITH CONTRACTING PROCEDURES WEAKENS THE BANK'S CONTRACTING PROCESS

From inception, the Bank has not fully complied with its contracting policies and procedures, and as a result, may have limited the competition for contract awards. Though the Bank recently adopted a new procurement manual, the contracting process still requires further guidance to assure adherence to the manual and to protect the Bank's interests. Only the Bank's willingness and ability to enforce all of its policies and procedures, however, can alleviate contracting weaknesses and secure the integrity of its contracting process.

HISTORY OF THE BANK'S PROCUREMENT POLICIES, PROCEDURES, AND RESPONSIBILITIES

The Bank's Board of Directors adopted an interim procurement policy in September 1979 to guide the Bank during its initial organizational efforts. The policy was brief and discussed the major issues of competition, affirmative action, and requests for procurement. The policy noted that the Bank would use the Federal Procurement Regulations as general guidelines.[1] The policy also stated that the Bank would deal openly and fairly in procuring goods and services at the lowest reasonable cost from qualified contractors. Along with this policy, the Bank issued Procurement/Contract Instructions in November 1979 as interim procedures for the guidance of Bank staff.

As of February 1980 the Board delegated procurement authority to the Bank President. The President approved the Procurement Procedures Manual in March 1981. This manual was quite detailed, specifying standard procedures for the delegation of authority, procurement of various types of services, and contract administration. The Bank used this manual until January 1983 when it adopted a new procurement manual. We discuss these changes on page 73.

From its beginning, the Bank used a centralized form of procurement. Presently, the Bank centers its procurement function in the Corporate Services Department of the Financial Administration Division. The Vice President for Financial Administration has the overall responsibility for the procurement of goods and services, and the Director of Corporate Services serves as the Bank's procurement (contracting) officer with the responsibility for the day-to-day management of procurement activities. The Bank's procedures, however, allow program officials to play a

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[1]An earlier decision by the General Services Administration stated that the Bank, as a mixed-ownership government corporation, was not required to follow Federal Procurement Regulations in the award and administration of contracts.

significant, if not central, role in all phases of procurement. In fact, the March 1981 manual detailed the responsibilities of both the program and procurement officers for each phase of procurement.

Our review of the Bank's contracts covered more than 2 years of Bank operations, from September 1979 to March 1982. At the onset of our review, the Bank had three systems for procuring services. The Bank designed one system for small purchases--purchases of supplies and nonpersonal services from commercial sources which were $10,000 or less; another for experts and consultants where the overall labor costs did not exceed $2,000; and a third for other personal and nonpersonal services such as services for technical assistance, research and demonstration, management consultants, study contracts, and equipment contracts.

As agreed with the committee chairman's office, we reviewed only contracts for other personal and nonpersonal services, since the Bank obligated most of its procurement money in this category and since the committee expressed primary interest in these contracts. We selected and reviewed a random scientific sample of 49 contracts[2] ranging in size from $600 to $125,000 from among the more than 200 awarded. The 49 contracts totaled about $1.2 million.

CONTRACTING PRACTICES HINDERED COMPETITION

We found that the Bank may have limited competition through its reliance on sole-source contracting. It awarded at least half of the contracts sole-source and for the majority of those contracts it did not complete the required supporting justification to explain the lack of competition. These actions were contrary to the stated Bank policy and procedures on contract awards.

The Bank's original policy based contract awards on competition wherever practical. This policy required limiting sole-source awards to situations in which only one source could, for all practical purposes, perform the contract. Original Bank procedures required a written justification for sole-source awards. Subsequent policy and procedures stated that no preferred solicitation method existed; however, they required documenting the rationale for the selected method on each contract by preparing a form which explained the source selection. The above policies and procedures were applicable for all contracts except those for technical assistance. The Bank had different procedures for awarding its technical assistance contracts. We analyzed the nontechnical assistance contracts in our sample separately from the technical assistance contracts in order to evaluate the Bank's compliance with its different award policies and procedures.

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[2]We originally selected a sample of 50 contracts from a contract listing prepared by the Bank. We subsequently discovered, however, that the Bank had canceled the award of one contract.

The results of our audit demonstrate that the Bank fell short of meeting its established policies. Of the 34 nontechnical assistance contracts, the Bank could provide some form of evidence that only 2, or 6 percent, were awarded competitively. The Bank awarded 17, or half, of the contracts sole-source, and Bank officials did not document or know the source selection of the remainder (15, or 44 percent). Furthermore, for 65 percent of the sole-source contracts, the Bank had not prepared the required written justification.

As for the technical assistance contracts, the March 1981 manual provided for a different set of award procedures. The Bank, however, awarded most of its technical assistance contracts in 1980 before it adopted these procedures. Bank officials told us that the different award procedures for awarding technical assistance contracts existed at that time. Under those procedures, the Technical Assistance Division was to first prepare a list of qualified technical assistance contractors and then the Technical Assistance Review Committee, comprised of senior Bank staff, was to award contracts to contractors on the list. Bank officials indicated that the Bank awarded technical assistance contracts in this manner, but could not provide supporting documentation.

Both the former Procurement Director and the former Director of Technical Assistance, however, told us that the Bank did not have award procedures in place during the early summer of 1980 and that the Bank awarded some of the 1980 contracts before the contractors were determined to be qualified.

CONTRACT PROCEDURES AND TERMS NOT FOLLOWED

We found that the Bank did not always adhere to its contract procedures and did not take the required steps to assure that the contractors complied with all the contract terms. In 27, or 53 percent, of the contracts reviewed, the Bank did not meet one or more of its contracting requirements during award and/or contract administration.

Contract award procedures not followed

The procedures most often not followed during the contract award related to the timely preparation of procurement requests, allowance of the contractor to begin work before the Bank officially approved the contract, and the preparation of the required source justification.

Our review showed that in 8, or 16 percent, of the contracts, the Bank did not follow its procurement request procedures. The Bank's procurement procedures have always required that the program officer prepare a procurement request and send it to the procurement officer before preparation of the contract documents. The procurement request is a critical document in the procurement cycle. It alerts the procurement officer to the Bank's departmental needs and provides significant information concerning the scope of services, delivery schedule, and cost

estimate. It also identifies recommended sources and is used by the procurement officer in the preparation of a contract. We noted five cases where the Bank prepared the procurement request the same day it awarded the contract and three other cases where the Bank prepared the request for procurement after it awarded the contract. An untimely procurement request could jeopardize the effectiveness of a procurement action by not providing the procurement officer sufficient leadtime to ensure full competition and to obtain contracts most advantageous to the Bank in terms of cost and delivery.

We found that in 7, or over 14 percent, of the contracts the Bank allowed the contractor to begin work before the Bank signed the contract. As a result, contractors were able to provide services that may have been informally agreed upon with the Bank's program officer but never formally approved by the Bank President or designees.[3] This breakdown in the contract award process could have resulted, for example, in the Bank paying for technical assistance that authorized Bank officials considered unnecessary. It could have also resulted in the Bank agreeing to less than favorable contract terms since the contractor's work would have been already underway.

Our review of the contract files disclosed no evidence that a written justification had been prepared for 11 of the 17 sole-source contracts included in our sample. As previously discussed (p. 68), the Bank has always required some form of written justification for these awards. Again, this lack of documentation adds evidence to the weaknesses in the contract award process and to the technical violations of the Bank's procurement procedures.

<u>Contract terms and contract administration procedures not followed</u>

The Bank did not fulfill its numerous responsibilities in monitoring compliance with contract terms and contract administration procedures. Of these, the Bank most frequently violated the procedures for modifying and evaluating contracts. Moreover, in many instances, the Bank could not support that it required the contractor to meet the reporting and delivery terms of the contract.

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[3]The March 1981 manual stated that the President delegated unlimited signature authority to the Executive Vice President and limited authority of up to $5,000 to the Vice President for Management and to the Directors of the Technical Assistance and Housing Divisions. The former Director of Regional Operations stated that regional directors received limited authority for signing task orders which are specific requests for services under an existing contract. They received authority of up to $3,000 for commercial task orders and up to $1,000 for housing task orders.

The Bank sets forth its administrative procedures for modifying contracts and providing evaluations of contractors in its procurement manual. It establishes the specific terms to be met by the contractor such as reporting requirements and delivery terms in the contract document. The program and procurement officers share the responsibility for enforcing these procedures and terms.

Contract modifications are written alterations to aspects of an existing contract such as the contract's specifications, contract period, or program budget. These modifications should be made only during the life of a contract. However, the Bank modified 9, or 18 percent, of the contracts reviewed after the contract expiration date. For example, the Bank modified one contract 9 months after its scheduled expiration date in order to extend the contract and increase the program budget.

As a part of the contract terms, many contracts detail the frequency with which the contractor must submit written reports to the Bank's program officer on the status of the contractor's work. Of the 49 contracts, we found that 24 specified written reporting requirements. Of these, 17, or 81 percent, did not meet all the requirements. For some contracts, the Bank could not provide any evidence of the required task order completion reports and/or monthly reports. For others, the Bank did not have all of the monthly reports as required by the terms of the contracts.

As part of the contract closeout, the Bank's policies required a written evaluation of the contractor by the responsible program officer. In 59 percent of the contracts reviewed, we found no written evaluation of the contractor's performance. In addition, the Bank complied with the evaluation requirements for 14 percent of the contracts after we requested this information as part of our review. In these instances, the dates of the evaluations ranged from 7 to 30 months after the contract completion date.

Furthermore, in 16, or 33 percent, of the contracts reviewed, the Bank could not provide all the deliverables (end products) that the contract terms specified. In many instances, these missing deliverables were written summaries of the onsite technical assistance provided by the contractors. The absence of these deliverables raises a greater concern of whether the Bank paid for services never received. Once brought to the attention of senior Bank officials, the Bank located required deliverables in 5 of the 16 contracts.

OTHER CONTRACTING WEAKNESSES

We observed other contracting weaknesses throughout our review which probably contributed to the contracting weaknesses discussed above. We noted that the Bank did not adequately maintain its contract files. The official contract file which the procurement officer maintains did not always contain essential information such as justifications, progress reports, and deliverables. The program officers should have been able to provide much of this information; however, contract files kept by

program officers were frequently incomplete. In other cases, program officers were no longer employed at the Bank, no other Bank employee could provide assistance, and the Bank could not locate the program officers' contract files.

Certain factors appear to have contributed to this situation. For one, the procurement officer did not have the necessary authority to enforce contracting procedures. For example, the procurement officer did not have the authority to approve contracts, and as a result, could not control the early stages of the contracting process. Without this authority, the officer's position to provide the necessary checks and balances to the system was never fully realized. As a consequence, certain Bank officers were able to circumvent the contracting procedures.

Details of a July 1982 report by the Bank's Audit Division on contracting procedures that the Bank considers confidential are contained in attachment IV of a supplement to this report which we will not release to the public.

A significant turnover in staff coupled with poor contract administration may have also weakened the contracting process. For example, when the Bank abolished its Technical Assistance Division in June 1981, the Bank assigned the program responsibility for this division's contracts to remaining Bank divisions and departments. It assigned some of these contracts to the Procurement Department. However, the present procurement officer, who was not a Bank employee at the time of this decision, was unaware of this responsibility and consequently did not enforce all requirements for these particular contracts.

In addition, the present procurement officer believed that the March 1981 procedures, strongly based on federal procurement standards, were adversely stringent and time-consuming for an institution of the Bank's limited size and resources. Consequently, he did not require strict adherence to all these procedures. One program officer, also, stated that he often did not understand the need to comply with the formal reporting requirements of the contract, since he was in frequent contact with the contractor and aware of the contract's progress.

ORGANIZATIONAL CONFLICT-OF-INTEREST POLICY NEVER IMPLEMENTED

Less than 1 year after the Bank became operational, the Bank's Vice President for Management and certain other officials recognized the need for an organizational conflict-of-interest policy. Responding to this concern, the Bank President approved an organizational conflict-of-interest policy in March 1981, but the Bank later decided not to implement it. The Bank defined the term "organizational conflict of interest" as a relationship whereby an applicant for, or recipient of, technical assistance, or a contractor (including its employees, directors, consultants, or subcontractors) has interests, associations, or "inside information or access" which (1) may diminish its capacity to give objective assistance or advice or (2) may result in an unfair

advantage with regard to competition for contracts, loans, or assistance.

The policy required that the Bank inform contractors of its organizational conflict-of-interest policy by including it in contracts and by requiring contractors to sign a form before the award of the contract disclosing potential conflict. Such disclosure would have allowed the General Counsel's office to make a determination regarding the existence of conflict. If a question of conflict existed, the Bank then would have had the opportunity to review critical and sensitive issues regarding organizational conflict of interest before the contract award and determine whether the award should be made.

In response to our inquiry as to whether the policy was ever implemented, the Bank's former General Counsel explained in a July 1982 letter that the Bank had not developed the technical procedures for implementing the policy before the Bank hired him in November 1981. As General Counsel, he concluded that the principal objectives of an organizational conflict-of-interest policy would be addressed adequately through the Bank's general conflict-of-interest policy. He also concluded that an organizational conflict-of-interest policy, if implemented, would be more of an administrative burden and less of a benefit to the Bank.

We believe, however, that broad areas of organizational conflict of interest are not adequately covered by the existing general conflict-of-interest policy which addresses conflicts of interest among Bank employees and board members. For example, we noted one contractor's undated resume (located in the contract file) indicated that the contractor was a vice-president of the same emerging cooperative to whom the contractor was providing managerial assistance. Although we were unable to determine whether the contractor held both these positions simultaneously, available information suggests a relationship between the contractor and the cooperative.

Information from a March 1981 report by the Bank's Audit Division discussing organizational conflict of interest that the Bank considers confidential is contained in attachment V of a supplement to this report which we will not release to the public.

Regarding the administrative burden of an organizational conflict-of-interest policy, we believe that the contractor's disclosure of organizational conflict of interest as previously described would not be a great administrative burden on the Bank. Furthermore, if a conflict exists, it seems both prudent and critical to protect the Bank's interest and integrity with such a policy.

BANK IMPLEMENTS NEW PROCEDURES

The Bank adopted new procurement procedures in January 1983 to streamline and better reflect procedures of a private institution. We reviewed the procedures and believe that if properly enforced, they could alleviate many of the deficiencies we found

during our review. However, some procedures require further elaboration to protect the Bank from possible abuse.

The procedures provide the procurement officer with sufficient central control to monitor the Bank's contracting process. They require the procurement officer's signature for contract approval and more fully describe the role of various program officials involved in the process. Moreover, they set penalties for persons not adhering to Bank procedures. The procedures also outline the documents which must be placed in the official contract file such as justifications, modifications, reports, and deliverables, which we believe will improve the central control of procurement.

The new procedures, however, do not correct all the contracting weaknesses disclosed by our review. For one, they give authority to approve the purchase of professional or consulting services up to $5,000 without competition and without any written justification to regional directors, division heads, vice presidents, the Executive Vice President, and President. Department heads have the same authority up to $2,500. As our review showed, the Bank primarily used sole-source procurement even though the Bank's policies and procedures always stressed competitive procurement. We believe that the new procedures may also limit competitive contracting.

Additionally, the new procedures do not specify a format for the contractual document and do not always require a contractor's signature. The procedures state only that the Bank plans to use a purchase order for all procurement actions. A purchase order is a standard Bank form that briefly identifies pertinent procurement information such as vendor, description of goods or services, quantity, price, and accounting data, and contains the signature of the procurement officer. The procedures provide for the contractor's signature (to indicate acceptance of the terms of the purchase order) when determined by the procurement officer to be appropriate.

The procurement officer said that the Bank will use contracts or letter agreements to set forth the contract terms when determined necessary. These instances would include contracts over $10,000 and contracts for personal services. He said that these documents would require the signature of the contractor to indicate acceptance of the terms and conditions of the contract.

Further, the procurement officer said that the Bank will no longer use general provisions. The Bank previously included these provisions in the contractual document to both inform the contractor of Bank requirements and protect the Bank's rights in areas such as suspension and termination of contracts, and ownership of documents. The procurement officer told us that the Bank intends to include necessary terms in the letter agreement or contract to protect the Bank's interests but not in the form of general provisions. He stated that he will tailor the terms of the provisions to the individual contract.

We believe, however, that without written procedures requiring the contractor's signature and general provisions, the Bank cannot ensure the consistent application of its procedures. In the case of the procurement officer's absence or departure, the Bank would have no written guidance, therefore weakening its basic control and protection of the contracting process.

CONCLUSIONS

Since the Bank's inception, its officials have not always adhered to established contracting policies and procedures. Among other contracting weaknesses, the Bank awarded a large percentage of its contracts sole-source and without preparing the required justification, did not always timely prepare procurement requests, and allowed some contractors to begin work before contract approval dates. Such contracting weaknesses in combination with incomplete contracting files and a high personnel turnover did not ensure that the Bank both contracted for goods and services most economically and received all the goods and services for which it paid.

Even though the Bank adopted new procedures, the accrued benefits of the procedures will be determined to a large extent by the Bank's willingness and ability to enforce them. As mentioned previously, these procedures could correct many of the deficiencies that we noted. However, new procedures without a corresponding effort to enforce them could result in similar deficiencies occurring in the future.

Some of the Bank's new policies may not provide sufficient controls to guard against contracting abuses. By giving several Bank officials the authority to approve procurements up to $5,000 for personal services without competition and without written sole-source justification, the Bank could limit future competitive procurement. Moreover, the lack of written guidance on general provisions and contractor's signature could result in inadequate protection of the Bank's contracting rights. In addition, the Bank's earlier rejection of an organizational conflict-of-interest policy could have an adverse effect on the integrity of the contracting process.

The Bank needs to revise the contracting procedures to further ensure the integrity of the contracting process by:

--Establishing written requirements for including general terms in contracts such as suspension and termination of the contract, ownership of documents, and confidentiality of information. Without written procedures, the Bank cannot be assured that its rights and privileges will be properly protected in all contracts.

--Establishing written requirements for getting the contractor's signature on official contract documents.

--Requiring the next level of management to approve all noncompetitive procurements which are made without

written justification. For example, a department head requesting this type of procurement would have to get the approval from a division head or a vice president.

--Implementing the organizational conflict-of-interest policy by requiring, when applicable, the contractor to certify that no organizational conflict of interest exists between the contractor and contract recipients (cooperatives).

BANK COMMENTS AND OUR EVALUATION

The Bank agreed to establish written requirements for including general terms in contracts, to develop specific guidelines dealing with organizational conflicts of interest, and to study the need for establishing written requirements for getting the contractor's signature on official contract documents. Concerning our suggestion for requiring the next level of management to approve all noncompetitive procurements made without written justification, the Bank said that its current procedures require written justification in every procurement, except those exempted by the procurement policies. The exempted procurements[4] are the ones we believe should be approved by the level of management above the level initiating the procurement.

The Bank said that our analysis must be placed in perspective. First, it stated that our review covered the Bank's first 31 months of operation and included a number of contracts which the Bank awarded when there was no permanent Bank President or staff and when the procurement of services was critical to helping the Bank become operational. Second, it stated that certain violations such as allowing work to start before the contract was approved and failing to prepare written sole-source justifications occurred because Bank staff was unfamiliar with newly adopted procurement procedures.

While our contract sample did cover the contracts awarded during the first 31 months of Bank operation, the observed deficiencies were not concentrated in the early months but were found throughout the entire period. For example, the Bank awarded 2 of the 11 sole-source contracts without written justifications in February and March 1982--about 2 years after adopting its first contracting procedures and hiring a President and permanent staff.

The Bank said that the fact that a procurement request is prepared the same day a contract is awarded did not make the award improper and is not a violation of the Bank's procurement policies and procedures. It suggested that our criticism should be eliminated unless a violation of the Bank's procurement procedures can be found.

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[4]Authority for regional directors, division heads, vice presidents and above, to purchase professional and consulting services up to $5,000 and for department heads to purchase such service up to $2,500 without competition and without written justification.

We neither said the award was improper nor that the Bank's procurement policies and procedures were violated. However, in our opinion, preparing a procurement request the same day a contract is awarded does not give the Bank's procurement officer ample opportunity to select the most efficient and effective contract type--one of the primary objectives underlying the requirement for initiating procurement requests. Moreover, we found three contracts which were awarded before the procurement request was prepared and, for those cases, the procurement officer apparently had no input as to the type of contract used.

The Bank said it believed that the deliverables it could not find for the 11 contracts were inconsequential (i.e., progress reports orally waived by the program officers) and did not diminish the value of the work provided by the contractors. Contrary to the Bank's statement, the missing deliverables included written products required by the contract terms such as needs assessments and financial statements on cooperatives and final reports on the technical assistance provided to cooperatives. We told the Bank earlier that none of the deliverables in question involved missing progress reports and even met with Bank staff to determine which key documents they could not locate. At that time we again noted that none of these documents were progress reports but were end products as specified by terms of the contract.

CHAPTER 8

SHAREHOLDER AND PUBLIC RELATIONS EFFORTS IMPROVE

Although the Bank's past efforts in the area of shareholder and public relations were criticized by its shareholders, the Bank Board and management have taken, or are in the process of taking, several actions to increase the flow of information to, and feedback from, member cooperatives and the public in general. The Bank uses public hearings, annual meetings, and newsletters and other mailings to communicate with these groups. We discuss each of these communication methods in detail below.

Public hearings

The Bank uses public hearings to solicit public input on various issues. At its December 1979 meeting, the Bank's Board of Directors issued the Bank's proposed policies including subjects such as title I interest rates, eligibility and priorities, title II credits, the low-income definition, voting rights, and public observation rules for a 60-day public comment period. As part of its effort to obtain input on the policies, the Bank conducted public hearings in January and February of 1980 in 14 cities across the nation. The Bank received over 400 oral and written comments on these policies for its consideration.

To assist in the development of the new self-help corporation (CCDC), the Bank received suggestions from consultants, shareholders, and the public. Four consultants spoke to the Board's former Self-Help Committee and key staff members on June 24, 1982. The Board provided the shareholders and public an opportunity to speak on the goals and objectives of the new self-help corporation at a public session which followed the June 25, 1982, annual meeting in Washington, D.C. Eight individuals spoke at this session. The Bank invited written comments on the corporation in the Bank's May 1982 newsletter. The Bank Board held two other public hearings (discussed on p. 31) to hear comments on establishing the self-help corporation and changing the Bank's bylaws in September and October 1982.

Annual meeting

Another method the Bank has used to communicate with its shareholders is annual meetings. At the Bank's second annual meeting which we attended on June 25, 1982, the Board gave its shareholders an opportunity to speak and/or present resolutions to the Board. Seven shareholders addressed the Board. One shareholder introduced a resolution co-sponsored by 71 shareholders which requested that the Board give shareholders the authority to approve changes in the Bank's bylaws. The resolution was prompted by a belief that the Bank did not adequately consult with shareholders when it established Bank policies. The Bank's former General Counsel, however, advised the Board that under the Bank act only the Board had the right to adopt, change, or cancel the

Bank's bylaws. Subsequently, in an August 1982 letter, the Chairman of the Board stated that the Board would seek nonbinding shareholder input on broad Bank policies and problems. The Board revised the Bank's bylaws in January 1983 to require shareholder consultation wherever practicable.

Letters to shareholders

The Board's ad hoc Election Review Committee Chairman and the former Bank President sent the first of three letters on the elections to shareholders in August 1981. The letter requested them to submit comments on the qualifications needed by potential Bank Board members and the process and procedures for nominating and electing board members. According to the next shareholder letter sent by the Chairman of the Board and the former Bank President in September 1981, 38 cooperatives responded to the first letter and the Bank changed some of its policies as a result of their recommendations. The second letter requested shareholders to submit nominations for board members. A third letter sent in October 1981 explained changes in the voting rights policy. We discussed these letters and the Bank's responses to shareholder input in chapter 6.

In November 1981 the Chairman of the Board and the former Bank President requested shareholders to complete a questionnaire on the Bank's need to establish advisory councils to facilitate two-way communication between the Bank and its shareholders. Twenty-five organizations responded to the questionnaire. According to the Assistant Vice President for Marketing, the Board's Marketing Committee reviewed the results of this survey and discussed the need for the councils at several of its meetings in 1982. As a result, the Board's Marketing Committee approved new means of interacting with shareholders for 1983. The Executive Vice President scheduled trips to the regions to give him and Board members who will accompany him the opportunity to meet with shareholders. The meetings are designed to include a presentation of current development activities, an explanation of major Bank policies and procedures, and a question and answer period to encourage shareholder feedback. The Executive Vice President held the first of these meetings in Albuquerque, New Mexico, on April 16, 1983.

In addition, in December 1982, the Board's Executive Committee adopted a policy that the Board would hold biennial out-of-Washington meetings primarily to interact with local shareholders and regional office staff. The Board held such a meeting in Dallas, Texas, on April 15, 1983.

The Chairman of the Board sent 239 shareholders and 26 interested groups a letter in October 1982 concerning the Bank's policy on lending to producer cooperatives. The letter requested shareholder comments on whether the Bank should devote substantial staff resources to pursue lending to producer cooperatives in 1983 and whether the Bank should lend to cooperatives owned by for-profit firms. In the letter the Chairman stressed that this

request was ". . . part of the continuing commitment to inform Bank shareholders of evolving Board policy and to solicit your comments on that policy."

The Bank received 18 responses, including 14 from shareholders. In total, 16 respondents opposed lending to cooperatives owned wholly or partially by entrepreneurs and none opposed the Bank's devoting substantial staff to pursue lending to producer cooperatives in 1983. The majority of those addressing the issue expressed support for loans to worker cooperatives. In January 1983 the Board approved a policy of allowing staff to accept applications from producer cooperatives owned wholly or partially by entrepreneurs and established priorities for certain loans such as worker buyouts which reflectd the concerns of the shareholders and the Board members.

In December 1982 the Chairman of the Bank Board sent shareholders a letter disclosing the results of the Farm Credit Administration's October 1982 report on the Bank's loan portfolio. The letter also discussed some of the corrective actions which the Board had directed management to undertake in response to weaknesses reported by the examiners as well as by the shareholders. A more recent letter sent to shareholders (now called members) discussed the April 1983 reorganization.

Co-op Bank Notes

Another vehicle the Bank uses to inform shareholders and the public and request feedback is the Bank newsletter, Co-op Bank Notes. For example, the first issue of the newsletter (Oct.-Nov. 1980) contained the Bank's proposed public information policy and requested public comment on it. As of June 1983, the Bank had published 14 issues of Bank Notes which have included information on various topics such as pilot projects, the housing loan policy, regional activities, lending activities, and elections.

The Bank sends the newsletters to about 14,000 cooperatives, individuals, and organizations on its mailing list. For 1983, the Bank's Marketing Division planned to issue Bank Notes quarterly. The December 1982 issue invited its readers to submit comments and suggestions on the kinds of subjects they would like to have discussed in future issues. The Assistant Vice President for Marketing said that the Bank will include developments of direct concern and interest to shareholders in Bank Notes.

Cooperative information consortium

In January 1982 the Bank and five other national cooperative organizations formed the Cooperative Information Consortium to prepare a directory of the over 20,000 cooperatives in the United States. The purpose of the directory is to improve inter-cooperative communication, increase awareness of cooperatives, and pave the way for future cooperative projects. The Bank's Assistant Director of Promotions told us that copies of the directory should be available about September 1983. The Bank's Information Officer

has one copy of the directory which can be used to refer people who call the Bank on the toll-free telephone number to cooperatives in their local postal Zip Code zone.

Shareholder information service

In February 1983 the Executive Vice President reported to the Board that he had met with shareholder cooperative representatives to exchange ideas and solicit input on the Bank's shareholder communications efforts. He also reported that the Bank had inaugurated a new mechanism to communicate with its shareholders. The new service has two components. The first is a new newsletter, The Co-op Bank Shareholder Update[1] providing a monthly summary of the highlights of the Board's meetings and other news. The second is an exclusive shareholder request telephone line which shareholders can use to get more complete background information on items summarized in the Update.

Update presents the Board's policy issue calendar which is designed to provide shareholders and others with advance notice of issues coming up before the Board. For example, Update reported that the Board had scheduled adoption of the shareholder communications plan for its April 1983 meeting in Dallas. The Bank plans to issue Update after each Board meeting reserving the "Dear Member" letters for issues of special importance.

CONCLUSION

We believe that the Board has become increasingly aware of the need to more openly communicate with the shareholders and that the Board and the Bank management are taking actions to improve relations with shareholders and the public in general.

BANK COMMENT

The Bank agreed with our conclusion that it has taken or is taking actions to improve shareholder and public relations.

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[1]Newsletter renamed The Co-op Bank Member Update in April 1983.

CHAPTER 9

PERSONNEL POLICIES REVIEWED

WERE ALMOST ALWAYS CONSISTENTLY APPLIED

Our review of selected Bank personnel policies showed that those policies were consistently applied to the vast majority of employee records reviewed. We found that allegations of inconsistent treatment of employees involuntarily separated from the Bank were not supported by the information in their personnel files. Also, former Bank employees, whom we interviewed and who were involuntarily separated from the Bank, were unable to furnish evidence to support the allegations of inconsistent treatment.

In accordance with the Chairman's request and subsequent discussions with his office, we evaluated the consistency of application of the Bank's personnel policies and interviewed former Bank employees to obtain their comments on, among other matters, Bank personnel policies.

Because of the allegations of inconsistent application of personnel policies for employees involuntarily separated from the Bank, we decided to evaluate the Bank's application of these policies for the employees separated from the Bank from its inception through August 31, 1982--the date we started work on this segment of our review. The policies included in our evaluation were based on allegations of inconsistencies made to us by former Bank employees. The allegations applied to policies that were applicable to employees involuntarily separated from the Bank and included

--the number of weeks of severance pay granted to employees whose jobs were abolished, and

--advance notice required for employees fired.

To further evaluate the Bank's application of its personnel policies, we identified a number of other policies--starting salary limitation, completion of a job application or a resume, and preparation of a job description--for which we could readily check the consistency of applications. We then checked on the Bank's application of these policies for all full-time employees separated from the Bank--both voluntarily and involuntarily--during the period covered by our review.

EMPLOYEES SEPARATED FROM THE BANK

The Bank's personnel records show that from the Bank's inception through August 31, 1982, 124 permanent employees were separated from the Bank for the reasons shown on the following page.

Reason for separation	Number of employees
Resignation	69
Job abolished or reduction-in-force	41
Firing	14
Total	124

Our discussion of Bank policies for consistency of application is divided between those policies that were applicable only to employees who were involuntarily separated because their jobs were abolished or they were fired and policies applicable to all employees in our universe.

APPLICATION OF POLICIES ON INVOLUNTARILY SEPARATED EMPLOYEES

Our review of personel files showed that the Bank consistently applied its severance pay policy to employees separated from the Bank because their jobs were abolished due to a reduction-in-force or for some other reason. We found also that the Bank followed its policy that required prior notification of employees who were fired.

Severance pay policies

According to Bank records, of the 41 employees in our universe that were eligible for severance pay, 38 received the amounts to which they were entitled. Employees who are involuntarily separated from the Bank because their jobs were abolished due to a reduction-in-force (RIF) for programmatic or budgeting reasons were eligible for severance pay. Employees separated as a result of an adverse action or who voluntarily resigned were not eligible for severance pay.

For the first 2 years of its existence, the Bank either had no severance pay policy or it had an unwritten policy that changed frequently until the Bank's formal, written policy took effect in June 1982. The Bank did not have a severance pay policy, either formal or informal, until the June 1981 reorganization, but there were also no jobs abolished during that time period, according to the Bank's records and the Chief of Personnel Operations. For the employees whose jobs were abolished during the June 1981 reorganization, the former Bank President established the severance pay at 8 weeks pay at the employee's present rate of pay and a 30-day notice that they were being separated from the Bank.

The Chief of Personnel Operations said that the 8-week severance pay policy was a one time deal. She told us that this policy was based on a commitment that the Bank's former President and Executive Vice President made orally in 1981 during the time

that the Bank was struggling for its existence, as already discussed in chapter 2. She said that the Bank employees were concerned about job security so the former President and Executive Vice President announced that there was enough money to keep everyone on salary until October 1, 1981. The former President told us that she provided this generous severance pay because the affected employees had come to the Bank, in good faith, with the expectation that they would be employed for a long period of time. She also said the Board was not involved in the decision and, in fact, one Board member told her that 8 weeks severance pay was too generous.

After June 1981 the Bank revised its informal severance pay policy to provide for 2 weeks salary at the present rate of pay and 2 weeks notice, according to the Chief of Personnel Operations. Bank records show that the first employee to receive severance pay under the revised policy was separated from the Bank in January 1982. This policy remained in effect until June 1, 1982, when the Bank's formal, written severance pay policy became effective. Even though the formal severance pay policy was effective June 1, 1982, it was not formally announced until October 22, 1982, because, according to the Executive Vice President, the Bank had expected another round of job abolishments and wanted to announce some good news--a more generous severance pay policy--along with the bad news, to minimize the adverse impact on employee morale.

Regarding the reason why the Bank took over 2 years to institute a formal written severance pay policy, the Chief of Personnel Operations told us that during the early period of the Bank's existence the personnel office was concerned with a rapidly expanding staff rather than RIFs and the need for a severance pay policy.

The formal severance pay policy provided for a minimum severance pay of 2 weeks salary for employees who completed a 6-month probationary period, but who had less than 2 years service. Employees who have completed more than 2 years service were entitled to 2 weeks pay for each full year of employment. The new policy also provided for an age adjustment allowance for employees 41 years of age or older which increased the severance pay by 5 percent for each full year in excess of 40 years of age. The severance pay policy does not apply to employees such as Bank officers and other persons reporting directly to the President.

Our review showed the following number of employees received severance pay under the several versions of the severance pay policy in effect.

Time period	Policy	Number of employees
Inception until June 1981	None	0
June 1981	8 weeks pay and 30 days notice	21
July 1981--May 1982	2 weeks pay and 2 weeks notice	7
June 1982--August 1982	2 weeks pay plus service and age adjustment	10
Total number of employees receiving severance pay		38

Reasons why the other three employees whose jobs were abolished did not receive severance pay were:

--Two senior level officials received consulting contracts from the Bank at the time they were terminated.

--One employee was on sick leave without pay at the time of separation and according to the Chief of Personnel Operations a senior Bank official instructed the Personnel Office not to make a severance payment.

Separation for cause (firing)

The Bank's disciplinary policy provides that employees may be separated from the Bank for unacceptable behavior or performance. The policy states that the disciplinary action can range from a letter of reprimand to dismissal and includes illustrations of the type of actions that would result in some form of disciplinary action such as: the falsification of reports, destruction or theft of Bank property, and failure to perform in a satisfactory manner. The policy also provides that the employee shall be given 10 days notice of separation or, at the discretion of the supervisor, the employee may be separated immediately and given 10 days pay. Our review of the personnel files showed that 14 employees were fired through August 31, 1982. The Bank gave 11 of these employees 10 days notice and separated 3 immediately with the required pay; therefore, the Bank complied with its policy in all cases.

APPLICATION OF POLICIES ON ALL SEPARATED EMPLOYEES

Our review of the personnel file for each of the 124 employees in our universe showed that the Bank generally complied with the following personnel policies:

--Starting salary limitation.

--Completion of job application or resume.

--Preparation of a job description.

We were not aware of specific allegations related to these policies, but since one former Bank employee told us that the Bank's personnel policies were inconsistently applied, without specifying a particular policy, we decided to check on the Bank's application of these policies. The policies were selected because they were among the limited number of personnel policies we were able to determine (within the time frame for completing this review) whether the Bank was in compliance. Other Bank personnel policies such as the qualifications of a person hired for a particular job or the appropriateness of the amount of salary increase are very judgmental and would have required work beyond the scope of this review.

Starting salary limitation observed

The Bank's policy provided that an employee's starting salary should not exceed 115 percent of the salary received in his or her last position. The period covered by this policy was not fully documented. The earliest written record the Bank could furnish us showed that this policy was effective June 30, 1980. However, two employees hired before June 30, 1980, told us that the 115-percent limitation was applied to their starting salaries. Also the set of written policies the former Acting Director of Personnel and Training provided us in September 1982 did not include this policy. However, she told us that the policy was still operational as of August 31, 1982. Since Bank records did not show exactly when the 115-percent policy became effective, we eliminated employees hired before June 30, 1980, from our analysis.

We found that 76 employees in our universe were hired after June 30, 1980, and for 57 of these employees, the Bank complied with its starting salary policy. For the remaining 19 employees we found

--1 case where the employee's salary exceeded 115 percent of the previous salary and

--18 cases where the Bank did not have a record of the previous salary, as a result we could not determine whether the Bank complied with its policy.

The Chief of Personnel Operations told us that even though there was not always a record of an employee's past salary in the personnel folder, she did find out the former salary in every case. She noted that there is no requirement that a record of an employee's prior salary be retained in the personnel file. Without such a written record, however, the Bank cannot demonstrate that it complied with this policy in the 18 cases noted above.

Job application forms or resumes and job descriptions were in most files

The Bank policies state that job applications or resumes are to be obtained from each applicant. We found that 122 of the 124 files contained a job application and/or a resume, while only 2 files did not contain either document.

The Bank policies require that a draft position description must be forwarded to the personnel office for each position to be filled. Our review of the personnel files showed that 123 of the 124 files in our universe contained a copy of the employees' job description.

CONCLUSIONS

The Bank consistently applied its personnel policies to the vast majority of employee records reviewed. We found, however, that some policies had changed more than once since the Bank was created and that some of these policies were unwritten for parts of the time period covered by our review. The policy limiting the amount of an employee's starting salary was unwritten at the cutoff date for this phase of our review. We believe that the unwritten policies and the changes to several policies contributed to the perception that the Bank was not consistently applying its personnel policies.

In a newly created organization it is understandable that policies will be unwritten for a period of time and that some policies will change. We believe, however, that taking over 2 years to put a severance pay policy into effect was not reasonable. We believe further that in an organization such as the Bank, where personnel turnover has been high (e.g., the Bank had three Directors or Acting Directors of Personnel and Training within 1 year), continuity would be improved if all personnel policies were in writing. For these reasons, we suggest that the Bank prepare formal written personnel policies to the maximum extent practicable.

BANK COMMENTS AND OUR EVALUATION

The Bank commented that it appreciated our recognition that the personnel policies reviewed were consistently applied. It stated, however, that our criticism that Bank policies should be in writing is now outdated. As support for its comments, the Bank cited its policy limiting the amount of an employee's starting salary which it stated was dropped a year ago.

We believe that the Bank's comments support our conclusion that the Bank's personnel policies should be in writing to the maximum extent practicable because there is apparently some confusion within the Bank as to whether or not this policy was in effect during the period of time covered by our review. As noted on page 86, the former Acting Director of Personnel and Training told us in September 1982, that even though this policy was not a part of the written personnel policies, it was still operational.

CHAPTER 10

OBSERVATIONS ON THE BANK'S FUTURE

In accordance with section 116(a)(3)(A) of the Bank act, as amended (12 U.S.C. 3026), the Bank redeemed all of its class A stock held by the Secretary of the Treasury ($184.27 million) on December 31, 1981, in exchange for class A notes. The act requires the Bank to pay interest on these notes at a rate to be determined by the Secretary of the Treasury. Until October 1, 1990, annual interest payments cannot exceed 25 percent of the Bank's gross annual revenues less necessary operating expenses including a loan loss reserve. With the Secretary's approval, the Bank may defer payment of such interest. After December 31, 1990, the act requires the Bank to maintain a repayment schedule which will assure full repayment of the $184.27 million by December 31, 2020.

The Bank must make financially sound loans to creditworthy cooperatives if it is to mature into a viable organization capable of repaying its federal debt. Information provided by the Bank indicates that the number of creditworthy consumer cooperatives in the United States, other than housing cooperatives, is limited. The act, however, restricts the amount of new business the Bank can do with housing cooperatives.[1] Although one of the Bank's objectives is to help develop financially sound cooperatives, the Bank cannot demonstrate that it will be able to develop such cooperatives at the rate necessary to build the portfolio needed to meet its financial obligations in 1990 and beyond.

To help the Bank prepare for its future as a quasi-private organization seeking funds in the private financial market, the Bank in November 1981, contracted with a consultant from the Harvard Business School to analyze the Bank's long-term loan growth and capital requirements. In his November 24, 1981, report, the consultant assumed that the Bank needed to have $1 billion in assets by 1990 to operate as a viable financial institution.

For his projections, the consultant assumed that (1) liquid investments would be maintained at 10 percent of assets, (2) interest spread on loans would be 2 percent above cost of borrowings, (3) operating expenses would grow at a 7 percent rate until 1985 after which they will total 3.5 percent of assets each year, (4) reserve for loan losses each year would amount to 1 percent of average loans balances, (5) other revenue would grow slowly until 1986 after which it would amount to 1 percent of average assets each year, and (6) sales of Bank stock would amount to 1 percent of average loan disbursements. The consultant

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[1]Beginning on October 1, 1985, the Bank cannot make any new housing loans if the aggregate of all such loans outstanding exceeds 30 percent of the Bank's gross assets.

concluded that if the Bank realized his assumptions, it would have an adequate earning capacity through 1990 and its capital requirements would not be a problem, even after 1990.

The Bank's Vice President for Financial Administration informed us that by 1990 the Bank's loan portfolio will be less than the necessary $1 billion projected by the consultant, but neither he nor the Assistant Vice President for Marketing could make a reliable estimate as to how much less. Additionally, both the Bank's Vice President for Financial Administration and the Assistant Vice President for Marketing told us that the Bank could not make reliable projections for future loan growth. A primary reason cited was the uncertainty of the number of cooperatives that can currently qualify for title I loans or the number the Bank can develop to the point where they can qualify for such loans under the fluctuating nature of the U.S. economy in which cooperatives must operate.

The Bank's former President maintains that, contrary to the belief at the time the Congress established the Bank, there was and still is only a limited number of creditworthy consumer cooperatives in the United States. In response to the October 1982 FCA report (see p. 9), the former President said that the Bank had not initially adopted more conservative underwriting standards because of an insufficient demand for loans from borrowers who could meet commercial banking standards. For example, she said that at the time of FCA's examination in May 1982, the Bank had identified only 16 creditworthy cooperatives outside the housing sector and had lent a total of $4.7 million to 15 of them. The former President told us that the Bank had always looked at itself as a development bank and not a bank for servicing an existing market of creditworthy cooperatives.

During the October 1982 Board of Directors' meeting, the Chairman of the Board's Finance Committee said that, although the Bank receives many loan applications, the Bank has a limited amount of effective loan demand. He said that perhaps the belief that creditworthy cooperatives have limited access to credit is not as bad as people led the Congress to believe when it established the Bank. This committee chairman told us that his statements were strictly a personal opinion formulated by reviewing loan applications as a member of the Board's Credit and Lending Committee and were not the result of any comprehensive research of the matter.

A further indication of a limited market for low-risk loans was the Bank's inability to meet its lending targets in 1982. During 1982 the Bank approved title I loans totaling about $30.3 million, which totaled about 44 percent of its original lending goal and only about 52 percent of its mid-year adjusted goal. In its 1983 financial operating plan, the Bank stated that it missed its lending target in 1982 because (1) it was still in a start-up phase, (2) the cooperative community was still in a development stage, and (3) prospective borrowers postponed planned expansions because of general economic conditions.

The Bank has recognized the importance of developing financial scenarios for helping it assess its future direction. To reflect a slower lending pace and other developments, the Bank developed a preliminary scenario in July 1982 reflecting assumed loan growth of $50 million in 1983, increasing thereafter by an annual rate of 7 percent. This growth rate was to occur only if it could be financed with internally generated funds.

The Bank presented this scenario to its Board in July 1982 as part of a summary of the 1982 planning process. While the scenario's intended uses were not clearly identified, it projected that the Bank's annual net income for the 12-year period ending December 31, 1993, would range from a low of about $12.4 million for calendar year 1990 to a high of $23.5 million in calendar year 1989. Therefore, one could conclude from the scenario that the Bank would be able to generate enough income from investing and reinvesting its own resources to start repaying the class A notes held by the Secretary of the Treasury in 1990 and subsequent years.

In addition to the fact that the loan growth presented by the scenario is strictly conjecture, our analysis disclosed several major weaknesses in the scenario. These weaknesses could substantially change the picture of the Bank's financial future.

First, the Bank included title II investments, loans, income, and expenses with Bank operations even though title II activities were to be and are now governed by a separate nonprofit organization.

Second, the Bank did not make any provisions for (1) loan losses which, according to the Bank's reserve account, could total about 11 percent of loans outstanding on December 31, 1982, (2) interest payments due on government-held class A notes, which will probably be 25 percent of net income through September 1990, (3) class B stock sales which by law must be at least 1 percent of all new loans, and (4) income, other than interest on investments and loans, which amounted to about $235,000 in 1982.

Third, the Bank erroneously considered a portion of loan principal repayments as funds available for loan growth, failing to recognize that such funds must be reinvested in new loans just to maintain a constant loan balance. This error alone overstated substantially the amount of growth which can take place as well as the Bank's profit potential. For instance, the scenario shows that, by using its cash reserves and annual net income, the Bank could increase its portfolio from $110,675,000 on December 31, 1982, to $621,454,000 on December 31, 1993, or by $510,779,000. By correcting this scenario for only this one error, we estimate that the Bank has earned or will earn enough money to increase its portfolio by only $236,147,000--about $275 million less than the Bank had estimated. Furthermore, this correction changed substantially the Bank's projected net income, particularly for calendar years 1990 through 1993.

A table contained in attachment VI of a supplement to this report, compares the Bank's annual net income estimates before and after we corrected the error. The Bank considers this table confidential and we will not release it to the public. During the 4-year period ending December 31, 1993, the Bank had estimated its net income would total $67,637,000, but after correcting the scenario for the Bank's error, we computed that net income for the 4-year period would total $9,945,000, or only about 15 percent of the amount the Bank had estimated.

The Vice President for Financial Administration told us that the Bank is computerizing its financial data and would develop updated financial scenarios by May 1983. He said that his office would isolate the financial data related to title II and include provisions for the income and expense items omitted from the scenario. Also, he said that by using the computer the Bank can make better assumptions as to the repayment cycle of its portfolio.

Subsequent to the completion of our review and May 24, 1983, testimony before the Chairman, Subcommittee on Financial Institutions Supervision, Regulations and Insurance, House Committee on Banking, Finance and Urban Affairs, the Bank provided us an updated scenario dated June 8, 1983. Our observations on this updated scenario that the Bank considers confidential are contained in attachment VII of a supplement to this report which we will not release to the public. Our analysis of this scenario showed that the Bank corrected the omissions and error we noted in the earlier scenario. However, we observed that this scenario still reflects a very optimistic, and possibly somewhat unrealistic, picture of the Bank's future.

CONCLUSIONS

The Bank is at a crossroad in its development. The Bank fully understands that for it to succeed as a viable institution, its portfolio must grow and that growth must take place by making financially sound loans. Because apparently the number of cooperatives that can qualify for such loans is limited, the Bank's future hinges largely on its success in developing creditworthy cooperatives. Although it cannot demonstrate that it will be capable of developing financially sound cooperatives at the rate necessary to mature into a viable organization and repay the federal government, its situation should be tempered by the fact that the Bank has been operational for only a little over 3 years and may not have had the time needed to demonstrate an ability to develop a cooperative community as envisioned by its charter. Also, as discussed in chapter 2, the Bank has had to adjust to the loss of financial support from the federal government and has had to contend with much turmoil resulting from changes made within its organization.

BANK COMMENTS AND OUR EVALUATION

The Bank acknowledged our conclusions that the Bank (1) understands the need to expand its portfolio by making financially sound loans, (2) has had a short time to demonstrate the full potential of the cooperative market, and (3) has had to adjust to the loss of financial support from the federal government. However, the Bank said that the draft report dwells on an outdated scenario presented to its Board in July 1982. It said that the analysis was intended primarily to demonstrate that the Bank's future financial viability did not require a $1 billion portfolio, as had been indicated in earlier projections and still made that point even when corrected for weaknesses we identified. Further, the Bank said that within the last year it had obtained data processing equipment which permits it to more reliably project long-term financial performance.

As noted on page 91 of this report, the Bank provided us an updated scenario dated June 8, 1983, which did correct the omissions and error we noted in the earlier scenario. We believe that, however, the updated scenario still reflects a very optimistic and somewhat unrealistic picture of the Bank's future. The Bank projected a rather small annual increase in operating expenses for the 10-year period beginning January 1, 1984, and did not make any allowance for interest income not collected on non-accrual loans which equaled about 20 percent of its loan interest income in 1982.

The most critical factor, however, is that the Bank could not demonstrate that it will be capable of developing the cooperative community it needs to make enough financially sound loans to allow portfolio growth to the size and quality needed to meet its long-term financial obligations. The updated scenario projects very large increases in commercial loans--the area the Bank is heavily dependent on for portfolio growth because of its legislative ceiling on housing loans. The Bank believes that the assumptions which it used, among other things, to project the thirteenfold increase in commercial loans are not optimistic when compared tothe trend of performance over the past 3 years. The Bank said, however, that only time will tell whether it can develop the number of cooperatives needed for making enough loans to allow for portfolio growth of the size and quality necessary to meet its long-term financial obligations.

In support of its position that its projected commercial loan growth is not optimistic, the Bank said that the percent of title I loans classified as high risk by FCA in the universe of loans made subsequent to June 1981 was only a small fraction of the percent of such classified loans in the loan universe made prior to that date. Also, the Bank said that the amount of loans it has approved is right on its 1983 target.

In our opinion, the information provided does not fully support the Bank's position. We recognize that the overall

quality of the Bank's loans improved during the period June 1981 through December 1982, but Bank experience shows that loan approvals are tentative and, as such, are not a good indicator of actual loan growth. A complete version of our evaluation of the Bank's comments that contains information that the Bank considers confidential is contained in attachment VIII of a supplement to this report which we will not release to the public.

THE CO-OP BANK

1630 CONNECTICUT AVENUE, N.W., WASHINGTON, D.C. 20009 (202) 745-4600

July 18, 1983

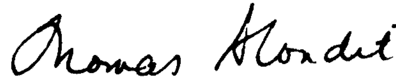
Mr. J. Dexter Peach
Director
Resources, Community & Economic
  Development Division
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20058

Dear Mr. Peach:

Enclosed is the National Consumer Cooperative Bank's response to your request for our comments on your draft of a proposed report, "The National Consumer Cooperative Bank: An Organization in Transition." The enclosed comments represent the tentative position of the Bank and are subject to reevaluation when the final version of this report is received.

We appreciate the opportunity to comment on the draft report before its publication.

Sincerely,



Thomas S. Condit
President

Enclosure

NATIONAL CONSUMER COOPERATIVE BANK

COMMENTS OF THE NATIONAL CONSUMER COOPERATIVE BANK
ON THE
GENERAL ACCOUNTING OFFICE'S DRAFT REPORT
"THE NATIONAL CONSUMER COOPERATIVE BANK: AN ORGANIZATION IN TRANSITION"

The draft General Accounting Office (GAO) report concerning the National Consumer Cooperative Bank generally analyzes practices and decisions made during the Bank's first two years of operations. Some of the examples represent activities that took place nearly four years ago.

The National Consumer Cooperative Bank (NCCB) has made changes during and since the conduct of this review which will be discussed later in these comments. A number of these changes were stimulated by the earlier reports of the Farm Credit Administration and the Bank's own auditors, as referred to in the draft GAO report.

In providing our comments we have summarized GAO's major findings and included our response to each finding in the section indicated.

CHAPTER 3 - BANK'S ORGANIZATIONAL STRUCTURE

Summary of GAO's Comment

During its short history the Bank has made several organizational changes, been converted from a mixed ownership corporation supported in part by Federal Appropriations to a quasi-private institution, and experienced high personnel turnover. It announced a reorganization in April, 1983 unifying its lending process, closing three regional offices, and converting two others to branch offices. GAO believes that these actions should improve the delivery of financial assistance to cooperatives, increase administrative effectiveness, and reduce operating costs. However, reducing the number of regional offices and staff will limit the Bank's ability to develop co-ops nationwide. The Bank's ability to develop new cooperatives is directly tied to its ability to repay the government.

Bank's Response

Of course, the Bank agrees with GAO as to the significant impact of the federal government's withdrawal of funds for the Bank and the efficacy of the 1983 reorganization. We disagree, however, on the impact of the reorganization on developmental activities and believe the report underestimates the offsetting effect of the Consumer Cooperative Development Corporation (CCDC) becoming operational.

The Bank has never had the asset base to support a full scale nationwide lending operation, choosing instead to concentrate resources in areas of most likely cooperative activity. Nevertheless, the Bank operated an extensive regional system unique to a bank our size and especially tailored to address our development mandate for nearly two years. When the Bank lost access to federal funds we no longer had the resources to continue the operation of a system this size. Meanwhile, the regional system had failed to obtain the desired developmental results--either in new loan volume or new cooperatives. When something is not working, the Bank will change it; accordingly the Bank scaled back its regional office system from eight full service offices to three. In addition,

Comments of the NCCB on the GAO Draft Report 7/18/83
Page 2

the Bank established two branch offices with two staff positions each expressly devoted to co-op development.

The GAO draft report notes the considerable staff turnover during the Bank's history. This issue cannot be fairly judged without taking into consideration the impact of the Reagan Administration's rescission proposal and the subsequent termination of the Bank's federal appropriations. When the rescission was proposed, much of the Bank staff quite correctly concluded that even if Congress did not eliminate the Bank, it would probably reduce the Bank's funding. The implication of any reduction in funding was a reduction in the size of the Bank staff. The Administration's proposal induced many people to leave the Bank--and it was quite difficult to replace them. The actual funding cutback did stimulate a reduction in staffing. The Bank has cut its staff by nearly 50% in the past two years. The cutback was accomplished mainly through reductions in force. In addition, many people resigned contemplating additional reductions in force. Often, job slots left vacant by resignations were also eliminated.

CHAPTER 4 - TITLE II ACTIVITIES

Summary of GAO's Comment

Until December 1982, the Bank maintained a separate Self-Help Office on paper, but that office was effectively eliminated in June, 1981 by the Bank's merger of its Title I and Title II lending functions. Because of the loss of federal funding, GAO found that emphasis given to Title II activities has continued to decrease. GAO believes that the separate self-help corporation now being established to administer the Title II activities in accordance with the 1981 amendments to the Bank Act, may help restore visibility to cooperative development and outreach activities. However, it is unclear whether the corporation will receive sufficient funding from the Bank or other sources to do so.

Bank's Response

While the Bank is not satisfied with the effectiveness of our Title II activities, the GAO appears to criticize the Bank's effort. In extremely difficult circumstances, the Bank has strived to live up to the developmental mandate imposed by Title II of the Bank Act. The Bank's actions toward Title II activities initially were hampered by the failure of the Carter and Reagan Administrations to appoint the Director of Office of Self-Help Development. Subsequently, our experience indicated that work of the Office was duplicative or uncoordinated with the Bank. This resulted in wasted expenditures, poor decisions, and frustrated borrowers. Finally, federal funding for the Office of Self-Help was terminated. During all this time, the Bank's response was not to drop developmental activities. Rather, the Bank went to great lengths to continue and refine these activities even after losing government appropriations. Still, once appropriations were terminated, some reduction in Title II activities was inevitable. We share GAO's belief that the new Consumer Cooperative Development Corporation program should correct any misconception that the Title II program is not actively being pursued. We agree that funding will be a question for the CCDC given that the original legislation contemplated the federal government, not the Bank, financing the CCDC in perpetuity. The Bank can and will provide the CCDC with adequate support in the near term while alternative financing arrangements are developed.

The report seems to criticize the Bank's commitment of resources rather than results. Sufficient weight is not given to the length of time required to measure the success of development work. For example, the pilot project program is the Bank's program specifically aimed at generating new commercial cooperatives. The program has generated an additional new cooperative--a shopping center in a depressed neighborhood in Detroit since the completion of the audit. Co-ops supported by the program have received loan commitments totalling nearly $7 million. The Bank's experience with the program demonstrates that money alone is not the answer for new or weak cooperatives. Development work is labor and capital intensive--requiring, at minimum, a committed sponsor, experienced management, and a valid market opportunity.

CHAPTER 5 - REGIONAL OPERATIONS

Summary of GAO's Comment

Regional staffing was limited relative to their assigned responsibilities and the geographic areas to be covered.

Bank's Response

In 1981, when Congress stopped providing appropriated funds, it neither altered the Bank's mandate to do business nationwide nor provided it with sufficient resources--either through the requisite capital base or federal appropriations--to maintain the present regional system. Commercial banks do not operate throughout the country unless they are many times our size. In fact, the Bank informed Congress that even in 1981 it would have required at least $1 billion in assets--about five times what we have now--to even attempt to operate nationwide. Since our mandate remained unchanged, and our resources are limited, the challenge is to conduct nationwide operations with fewer resources than originally contemplated. This has resulted in concentration of resources in geographic areas most likely to yield results.

CHAPTER 6 - THE 1982 ELECTION OF BANK BOARD MEMBERS

Summary of GAO's Comment

The 1982 election contained several questionable practices. For example:

- The Bank established more stringent eligibility requirements for the purchase of voting stock after it announced the election. The new requirements were not consistently applied.

- The Board decided to disqualify five ballots because an officer other than the secretary certified election documents. The election rules allow for other officers to certify when authorized to do so by the cooperative. This decision appeared inconsistent with decisions made on other questionable ballots. The Board's decision on these five ballots changed the election outcome.

- Someone opened five election envelopes before the official election date and did not record who opened the envelopes and the circumstances leading to the premature opening. Once the seal was broken, a ballot could have been

replaced undetected because the official ballot contained no identifying marks.

The Board reviewed the election process and concluded in a May, 1982 report to its shareholders that the election was handled with integrity and was completely in accordance with the election rules. GAO found that the report contained several inaccurate or misleading statements. GAO believes that the Board needs to reevaluate the election process and the ramifications of its decisions and then decide what corrective action, if any, it should take.

Bank's Response

Eligibility Requirements

The GAO believes that it was improper for the Bank to establish more stringent eligibility requirements for the purchase of voting stock after it announced the election.

Prior to this time, the Bank had permitted co-ops desiring to purchase NCCB stock to self-certify that they met the Bank Act's eligibility requirements. The decision to end the practice of permitting prospective members to self-certify eligibility to own stock was consistent with the Board's expressed desire that "bogus" cooperatives be kept from membership. In fact, it is arguable that the Bank would now be criticized if the self-certification procedure had been in effect.

The report does not give sufficient weight to the Bank's decision not to disqualify any shareholder that had been previously deemed eligible. For example, even though the Bank decided that it should no longer use a system of self-certification, and even though the Bank twice asked each self-certified cooperative to provide documentation, the Bank thought it more unfair to apply rules retroactively and deprive shareholders of their voting rights. It is well recognized not to be unfair to "grandfather" recipients of benefits when rules are altered after the benefit is received, even if the result is subsequent identical applicants for the same benefit are denied that benefit through a prospective application of the rules.

Other than self certification, the only other change in the election procedures specifically criticized by the GAO was the requirement that the General Counsel's office obtain a written confirmation from the Secretary of State that the cooperative was certified to do business in the state. Previously, an oral confirmation had been required. This again does not seem inconsistent with the expressed intent of the Board or a breach of proper election procedure.

GAO also stated that the requirements were not applied consistently. Apparently a number of new members that did obtain certification had certain minor deficiencies. The only explanation we have is that attorneys who were then members of the General Counsel's staff did not execute properly--either intentionally or accidentally--their responsibilities to apply the membership criteria.

Disqualified Ballots

GAO found that the Board disqualified 5 ballots which, in GAO's opinion, should not have been disqualified. While GAO is welcome to its opinion as to what ballots should or should not have been disqualified, the simple fact is that the Board made a judgment in a perfectly legitimate fashion and the GAO's opinion is strictly from hindsight. The disagreement as to what ballots should have been disqualified only arises because of a minor discrepancy between the election rules and the ballot instructions. The election rules state that any official of a cooperative who is authorized to certify its corporate documents could certify the ballot. The ballot instructions expressly directed voters to have these documents signed by the corporate secretary. If the Board had included those ballots signed by another person other than the corporate secretary, undoubtedly the Bank would have been subject to criticism for not following the rules laid out in the instructions.

The GAO concludes that the exclusion of these ballots affected the outcome of the election, but at the same time questions the inclusion of other ballots. Would the election results have changed if the Bank had also excluded the ballots GAO questioned? Would the election result have changed if the five ballots had been included but the questioned ballots excluded? Why focus on only one variable? All of this speculation on various scenarios ignores the most critical point: GAO has not disclosed any evidence that the Board knew (i) whose ballots were being raised for decision, (ii) how many votes were involved or (iii) what effect various decisions would have had.

Opened Envelopes

The GAO says that there were five election envelopes[1] opened before the official election date that had no indication as to who opened them. If true, this is news to the Bank. The Bank had understood that there were three ballots inadvertently opened by Bank mailroom and clerical staff prior to the official election date and that they were so marked. It is our understanding that while the workpapers may indicate that additional envelopes had been opened there is no way to tell from the workpapers whether this was because the outer envelope was opened (thus providing an opportunity for a ballot to be switched) or because an inner envelope was opened (indicating that the sender did not seal the envelope and providing no such opportunity). Presumably, if there was an opportunity for mischief, the CPA firm would have flagged the matter at the time.

Shareholder Report

The GAO concluded that the Board's report to the shareholders contained inaccurate, incomplete, or misleading statements. GAO takes issue with the report's statements that the CPA firm assisting in the vote count certified the election, that every effort was made to qualify eligible cooperatives, that the

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[1] In order to assure secrecy, shareholders were sent two envelopes and were instructed to place the ballot in the "inner" envelope and that envelope plus a designation of the co-op's voting representative in a pre-addressed envelope (an "outer" envelope).

vast majority of cooperatives that submitted applications to purchase stock were able to vote, and that no official envelope had been opened prematurely.

The Bank believes that this analysis itself is quite unfair. There was no attempt to mislead our shareholders. Perhaps the Bank could have chosen a better word than "certify" to describe the CPA firm's role in the election, but the letter's language was intended to communicate that the firm certified the results of the tally not that the firm "controlled" the election. If the firm did not certify the election because they did not control all aspects of it, then the shareholder's report certainly lays out in great detail those tasks performed by the firm and those tasks performed by the Board and by staff. Given this detail, the Bank does not consider this statement misleading.

As to whether "every effort" was made to qualify eligible cooperatives, this is strictly a judgment call. As to the statements regarding the number of cooperatives not approved to vote in the election, the Board was not deliberately hiding any relevant information, but took a different base for measurement than the GAO.

Of course, the report said that no official envelope had been opened prematurely because the Bank did not know then and does not know now that an "outer" envelope had been opened prematurely.

The Board is quite concerned that the next election avoid any similar questions. The Board intends to issue procedures for the 1984 election well in advance of the next annual meeting.

CHAPTER 7 - CONTRACTING PROCEDURES

Summary of GAO's Comment

Bank officials have not consistently followed established contracting policies and procedures.

Bank's Response

The GAO's analysis must be placed in perspective. The GAO reviewed the execution of contracting procedures during the Bank's first 31 months of operations. A number of contracts in the GAO sample were awarded in the first months of the Bank's existence when there was no permanent Bank president or staff. Analysis of this period of time is not terribly meaningful. The contracts were primarily for services the Bank required early in its existence to help the Bank to become operational. Time was of the essence. Many contracts were awarded sole-source to firms and individuals with the required capabilities and proven performance records in an attempt to provide assurance that the contract requirements would be completed satisfactorily and in a timely manner.

As with any new organization, the Bank had to develop procurement policies and procedures and to educate the staff in their use. This is not an easy process. Even in established organizations new procedures require adjustment. The Bank developed its original procurement policies and procedures based on the policies and procedures required by the Federal Procurement Management Regulations even though the Bank was not required to do so. As a result the policies and procedures adopted were too stringent and not well suited for the Bank given

the nature of the organization, its mission and the resources available for contract administration. In January, 1983, the Bank adopted new Procurement Procedures which more closely parallel those customarily used in the private sector.

The GAO report cites instances where contractors were permitted to begin work before the approval of the contract and where sole-source justifications were not prepared. We believe that these violations occurred primarily because Bank staff unfamiliar with the newly adopted procurement procedures anticipated a sole-source contract and made commitments to contractors.

The GAO report cited eight instances where the Bank did not follow its procurement request procedures. Of the eight cases cited, five were instances "where the Bank prepared the procurement request the same day it awarded the contract." The fact that a procurement request is prepared the same day a contract is awarded did not make the award improper and is not a violation of Bank procurement policies and procedures. This criticism should be eliminated unless some violation of the Bank's procurement procedures can be found.

GAO indicates that the Bank could not provide deliverables for 16 or 33% of the contracts reviewed. The Bank has provided additional deliverables since completion of the draft report. Therefore, the statistics should be revised to reflect that deliverables could not be found for 11 or 22% of the contracts reviewed. We believe that with these contracts the missing documents were inconsequential (i.e. progress reports orally waived by the program officer) and did not diminish the value of the work provided by the contractor.

GAO stressed the need for enforcement of the new procurement procedures and made four specific recommendations for revising the contracting procedures to further ensure the integrity of the contracting process.

The first GAO recommendation to improve the Bank's contracting process would have the Bank establish written requirements for including general terms in contracts. The Bank accepts this recommendation and revised procedures will specify when certain contract provisions will be required with various types of contracts.

The second recommendation of the GAO which would have the Bank establish written requirements for getting contractor signatures on official contract documents is under review.

The third GAO recommendation would have the Bank establish a requirement to have the next level of management approve all non-competitive procurement made without written justification. The Bank's current procedures for justification of non-competitive procurement (except those exempted by the procurement policies) require written justification in every case.

The fourth recommendation of the GAO would have the Bank implement an organizational conflict of interest policy which would require contractors to certify as to their affiliation with cooperatives when technical assistance is being provided. The Bank accepts this recommendation and will include specific guidelines dealing with organizational conflicts of interest in its revised policies and procedures.

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CHAPTER 8 - SHAREHOLDER AND PUBLIC RELATIONS

Summary of GAO's Comment

Bank Board and management have taken, or were in the process of taking, several actions to increase the flow of information and feedback from member cooperatives and the public in general.

Bank's Response

We appreciate that GAO has recognized the steps that the Bank has taken and is taking to improve our member and public relations.

CHAPTER 9 - BANK PERSONNEL POLICIES

Summary of GAO's Comment

The Bank had consistently applied the personnel policies reviewed.

Bank's Response

We appreciate that the GAO recognizes that the Bank has consistently applied our personnel policies. The draft report's criticism that Bank policies should be in writing is now outdated. The report expresses concern that a policy limiting the amount of an employee's starting salary was unwritten at the completion of the audit. That policy was dropped a year ago.

CHAPTER 10 - THE BANK'S FUTURE

Summary of GAO's Comment

The Bank fully understands that for it to succeed as a viable institution, its portfolio must grow and that growth must take place by making financially sound loans. Since apparently the number of established cooperatives that can qualify for such loans is limited, the Bank's future hinges largely on its success in developing new creditworthy cooperatives. This situation should be tempered by the fact that the Bank has only been operational for only a little over three years and may not have had the time needed to demonstrate an ability to develop a cooperative community as envisioned by its charter. The Bank has had to adjust to the loss of financial support from the federal government and has had to contend with much turmoil resulting from changes made within its organization.

Bank's Response

The draft report dwells on a scenario presented to the Bank's Board in July, 1982 which is outdated. This preliminary analysis was primarily intended to demonstrate that the Bank's future financial viability did not rest largely on our ability to generate $1.0 billion in loans by 1990, as had been indicated by earlier projections. Indeed the analyses showed that the Bank would be able to "satisfy its financial obligations and survive as a viable financial institution" at substantially lower levels of loan growth. Even when corrected for the weaknesses identified by the GAO, the analysis still makes this essential point.

During the past year, the Bank obtained data processing equipment which permits its to more reliably project long term financial performance. The GAO notes the conjectural nature of the Bank's projections, but conclusions based on long range forecasts will by their very nature be conjectural. The Bank believes that the assumptions in the report are not optimistic when compared against the trend of performance over the past three years rather than the aggregate performance. As the GAO indicates, only time will tell.

We do note that GAO recognizes that the Bank understands the need to expand our portfolio by making sound loans and the short time we have had to demonstrate the extent of the cooperative market. We also appreciate GAO's recognition of the impact of the loss of financial support from the federal government, the ramifications of which are difficult to overestimate.

OBJECTIVES, SCOPE, AND METHODOLOGY

At the request of the Chairman, House Committee on Banking, Finance and Urban Affairs, and several subsequent meetings with the chairman's office, we reviewed the following areas at the National Consumer Cooperative Bank:

--The basis for the Bank's organizational structure and plans to change it.

--The emphasis the Bank has devoted to nonloan activities authorized in title II of the Bank act, including services to cooperatives with predominantly low-income members.

--The operation of the Bank's regional office system.

--Certain aspects of the January 1982 Board of Directors election.

--The Bank's contracting process.

--Communication between the Bank and its shareholders and the public.

--The consistency of the application of Bank personnel policies.

The following sections provide a detailed scope and methodology for each of these major subject areas as requested by the chairman and/or agreed to in subsequent discussions with his office. We conducted our review from March 1982 to March 1983, except as otherwise noted. The review was made in accordance with generally accepted government auditing standards.

BANK ORGANIZATIONAL STRUCTURE

Our review concentrated on the Bank's organizational structure before the April 1983 reorganization and on the status of Bank actions to change this structure pursuant to Peat, Marwick, Mitchell, & Co. and the Farm Credit Administration studies. We limited our work on earlier organizational structures and changes to that necessary to understand the current structure.

We performed our review at the Bank's headquarters and conducted extensive interviews of current and former senior Bank officials, including the former President and the former Vice President for Management. We also reviewed Bank records, including those of the Acting President at the time the Bank began operating. The Bank had relatively limited documentation on the basis for its earlier organizational structures; therefore, we based much of the information in chapter 3 on interviews with Bank officials. Further, we reviewed reports by PMM and FCA discussing the Bank's organizational weaknesses.

TITLE II NONLOAN ACTIVITIES

To familiarize ourselves with the activities authorized under title II, we reviewed the legislative history of the Bank act and its amendments. We interviewed headquarters officials, regional staff, and former Bank employees concerning how they directed or carried out title II's nonloan activities. We reviewed files for selected technical assistance providers and recipients maintained in the headquarters and the regional offices we visited. These files included those technical assistance contracts reviewed as part of the contracting process.

We reviewed the drafts of key documents prepared by the Bank concerning the establishment of the nonprofit corporation mandated by the 1981 Bank act amendments. We discussed the new corporation with senior Bank officials and attended the three public comment sessions on the corporation held in Washington, D.C., Kansas City, and New York City. We attended meetings of the Bank's Board of Directors and the Board's former Self-Help Committee held since our review began in order to monitor the Board's progress in establishing the corporation. We also attended all open meetings of the CCDC Board of Directors and its Executive Committee as of April 15, 1983.

REGIONAL OPERATIONS

To review and evaluate regional office activities, we visited two of the more active regional offices--Oakland and New York City--and two of the less active offices--Boston and Atlanta--during the period from September to November 1982. We interviewed the regional directors, loan officers, loan development officers, and management assistants at each office visited. We also interviewed one credit analyst in New York City. At the regional offices, we reviewed selected loan and/or loan management files, subject files, chronological files, and formal and informal activity reports. We reviewed reference materials and other publications available at the regional offices.

At the Bank headquarters, we interviewed officials of the former Regional Operations Division. We reviewed monthly activity reports, internal audit reports, an FCA report on the loan portfolio, reports prepared by management consultants involving regional operations, and resumes of regional personnel.

ELECTION PROCESS

We evaluated the Bank's 1982 election process, concentrating on the procedures for (1) nominating candidates, (2) qualifying stock purchase applications, and (3) qualifying and counting election ballots. We performed our review primarily at the Bank headquarters in the Office of General Counsel and the Office of the Secretary to the Board.

We reviewed the Bank's records on Board nominees, shareholders, and other matters. We interviewed senior Bank officials, including the former President, the Executive Vice President, the former General Counsel, and other Bank officials involved in the election. We also interviewed the former Acting General Counsel, other pertinent former officials, and an outside organization that had information on how the election was conducted. We also interviewed officials of and obtained pertinent records from Touche Ross & Co., a firm the Bank hired to assist in the vote count. We did not contact the Bank's shareholders because of the Board's pledge that the ballots would remain secret.

CONTRACTING PROCESS

Our review of the Bank's contracts covered contracts awarded from September 1979 to March 1982. We reviewed only contracts for other personal and nonpersonal services (such as services for technical assistance, research and demonstration, management consultants, study contracts, and equipment contracts), since the Bank obligated most of its procurement money in this category and since the chairman's office expressed primary interest in these contracts. We selected and reviewed a random scientific sample of 49 contracts ranging in size from $600 to $125,000 from among the more than 200 awarded. The 49 contracts totaled about $1.2 million.

We gathered standard information on each contract, including data on the contract's terms as well as the contract's award, administration, modification, and evaluation. For each contract, we reviewed the official procurement file and the individual program file. We also interviewed current and former Bank officials responsible for the procurement and monitoring of the contracts.

COMMUNICATION

In view of the concerns expressed regarding the adequacy of the flow of information to cooperative members and prospective members about the activities and plans of the Bank, we examined the Bank's efforts to communicate with its shareholders and the public in general. For this part of our audit, we did not review correspondence relating to individual loan transactions. We interviewed officials in the Bank's Marketing and Regional Operations Divisions and Office of the Executive Vice President, concerning the Bank's shareholder and public relations efforts. We reviewed various newsletters, reports, and other mailings which the Bank had sent to interested parties. We attended Board Marketing Committee meetings when the Committee discussed the Bank's Communication Plan for 1983 and other topics. We also attended Bank Board meetings and public comment sessions held in various cities during our review.

PERSONNEL POLICIES

We evaluated the consistency of application of selected Bank personnel policies and interviewed former Bank employees to obtain their comments on Bank personnel policies. We performed our review at the Bank's headquarters and reviewed personnel records maintained by the Personnel Department. The employees whose records we reviewed to determine if the Bank consistently applied its policies were the 124 full-time employees who left the Bank from its inception through August 31, 1982.

The Bank policies that we chose to include in our review were based on allegations made to us by former Bank employees and also other policies for which we could readily determine whether the Bank consistently applied its policies. We interviewed the former President, the Executive Vice President, the Chief of Personnel Operations, and other Bank officials.

Official Ballot

Place ballot in enclosed gray envelope

1. CONSUMER GOODS (Vote for not more than two)

- [ ] Kenneth B. Blaker
- [ ] Emile A. Curry
- [ ] Paul O. Mohn
- [ ] Cynthia C. Stapenhorst-Copple

2. CONSUMER SERVICES (Vote for not more than thr

- [ ] Madeline Fried
- [ ] Ann Adle Hoyt
- [ ] Dean A. Lund
- [ ] Harvey C. Sigelbaum

3. HOUSING (Vote for not more than two)

- [ ] C. Peter Behringer
- [ ] Alfred Reynolds
- [ ] Joe Rubenzahl
- [ ] James W. Smith

4. LOW INCOME (Vote for not more than two)

- [ ] Charles D. Bannerman
- [ ] John M. Perkins
- [ ] Maria Varela
- [ ] Charles R. Warner

5. OTHER (Vote for not more than three)

- [ ] Barbara Holsclaw Deverick
- [ ] Derek Shearer
- [ ] Charles Turner
- [ ] Morgan Williams

IMPORTANT: DO NOT VOTE FOR MORE THAN NINE

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