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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Review Of The Audit Of The National Consumer Cooperative Bank's Financial Statements For The Year Ended December 31, 1982

GAO reviewed the independent certified public accountant's audit of the National Consumer Cooperative Bank's (NCCB's) financial statements for the year ended December 31, 1982. GAO found nothing which would indicate that the independent certified public accountant's opinion on the financial statements is inappropriate or cannot be relied on. GAO therefore concurs with the opinion.

In the opinion of NCCB's independent certified public accountant, NCCB's financial statements present fairly the financial position of NCCB at December 31, 1982, and the results of its operations, and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The independent certified public accountant's work disclosed some internal control problems which were reported in a letter to management. These problems did not change the certified public accountant's opinion on these statements.

UNITED STATES GENERAL ACCOUNTING OFFICE

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GAO/AFMD-83-101
SEPTEMBER 30, 1983

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

B-200951

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

This report presents the results of our review of Peat, Marwick, Mitchell & Co.'s audit of the statement of financial condition of the National Consumer Cooperative Bank (NCCB) as of December 31, 1982, and the related statements of income, changes in capitalization, and changes in financial position for the year then ended. Our review was made pursuant to the provisions of the National Consumer Cooperative Bank Act (12 U.S.C. 3001 et seq.), which authorizes and directs the U.S. General Accounting Office to examine and audit NCCB.

In order to avoid unnecessary duplication and expense and to make the most efficient use of our available resources, we are relying on the work and report of NCCB's independent certified public accountant. We made inquiries, examined Peat, Marwick, Mitchell & Co.'s workpapers, and performed analytical procedures to determine the quality of the auditor's work and the extent to which we could rely on it. We reviewed the adequacy of the auditor's work on internal controls and compliance with laws and regulations.

In the opinion of Peat, Marwick, Mitchell & Co., NCCB's financial statements present fairly the financial position of NCCB at December 31, 1982, and the results of its operations, and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. During our review, we found nothing which would indicate that Peat, Marwick, Mitchell & Co.'s opinion on NCCB's 1982 financial statements is inappropriate or cannot be relied on. The auditor's work did not disclose any material noncompliance with laws and regulations.

As reported in its May 16, 1983, letter to NCCB, Peat, Marwick, Mitchell & Co.'s study and evaluation of internal controls disclosed the following conditions that it believes resulted in more than a relatively low risk that errors or irregularities in amounts that would be material in relation to NCCB's financial statements occurred and were not detected within a timely period.

--Loan origination and administration policies and procedures were inadequate.

--Information used as a basis for loan decisions was not properly documented.

--The lending authority of NCCB's officers was unclear.

--Responsibility for loan operations was divided among several NCCB divisions with no centralized accountability.

--Communication among NCCB's staff was poor.

--NCCB's financial and management information systems were inadequate.

Peat, Marwick, Mitchell & Co. stated in its May 16, 1983, letter that it has had continuing discussions about these conditions with NCCB's management and that NCCB has initiated corrective actions. Peat, Marwick, Mitchell & Co. also stated that the conditions were considered in determining the nature, timing, and extent of the audit tests applied in its audit of NCCB's 1982 financial statements and that the conditions do not affect its opinion on the 1982 financial statements.

We concur with and transmit to the Congress Peat, Marwick, Mitchell & Co.'s opinion on NCCB's financial statements. Peat, Marwick, Mitchell & Co.'s opinion and the financial statements are in appendix I.

We are sending copies of this report to the Director of the Office of Management and Budget; the Chairman of the Senate Committee on Banking, Housing and Urban Affairs; the Chairman of the House Committee on Banking, Finance and Urban Affairs; and NCCB's board of directors.

Charles A. Bowsher

Comptroller General
of the United States

Report of Independent Accountants

PEAT MARWICK

Peat, Marwick, Mitchell & Co.
Certified Public Accountants
1990 K Street, N.W.
Washington, D.C. 20006
202-223-9525

The Board of Directors
National Consumer Cooperative Bank:

We have examined the statement of financial condition of the National Consumer Cooperative Bank as of December 31, 1982 and the related statements of income, changes in capitalization and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements present fairly the financial position of the National Consumer Cooperative Bank at December 31, 1982 and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

As described in note 15, the accompanying statement of condition of the National Consumer Cooperative Bank as of December 31, 1981, and the related statements of income, changes in capitalization and changes in financial position for the year then ended were not audited by us and, accordingly, we do not express an opinion on them.

Peat, Marwick, Mitchell & Co.

March 31, 1983

National Consumer Cooperative Bank
Statements of Financial Condition December 31, 1982 and 1981

Assets

	1982	1981 (Note 15)
Assets		
Cash	$ 259,782	$ 748,439
Investments (note 3)	141,274,020	142,686,811
Funds in escrow accounts	—	5,406,662
Interest receivable	4,878,409	786,539
Loans (notes 4, 5 and 6)	75,596,693	54,741,323
Less: Allowance for losses (note 7)	8,411,911	6,049,563
Net loans	67,184,782	48,691,760
Fixed assets, net of accumulated depreciation of $273,031 in 1982 and $89,118 in 1981 (note 8)	988,555	576,350
Other assets	84,736	374,368
Total assets	$214,670,284	$199,270,929

Liabilities and Capitalization

	1982	1981 (Note 15)
Liabilities		
Accounts payable	$ 869,972	$ 550,696
Accrued interest on class A notes	3,010,912	—
Other accrued expenses	420,732	402,555
Commitment fees, deferred income and other credits (note 4)	1,471,759	17,547
	5,773,375	970,798
Capitalization		
U.S. Treasury class A notes (note 10)	184,270,000	184,270,000
Members' ownership		
Common stock (note 10)	5,825,521	5,872,014
Appropriations for operations	—	1,387,026
Retained earnings	18,801,388	6,771,091
	24,626,909	14,030,131
Total liabilities and capitalization	$214,670,284	$199,270,929

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

National Consumer Cooperative Bank
Statements of Income Years Ended December 31, 1982 and 1981

	1982	1981 (Note 15)
Interest earned from:		
Investments	$19,981,540	$ 8,936,059
Loans	6,691,647	4,517,793
Total interest earned	26,673,187	13,453,852
Interest expense (note 10)	3,547,757	–
Net interest income	23,125,430	13,453,852
Provision for loan losses	2,470,135	5,662,830
Net interest income after provision for losses	20,655,295	7,791,022
Other income	234,701	122,044
Operating expenses		
Salaries and employee benefits (note 11)	4,903,565	5,518,659
Contractual services	2,857,895	2,545,445
Occupancy and equipment expenses (note 9)	1,221,490	680,571
Other expenses	1,263,775	1,195,574
Total operating expenses	10,246,725	9,940,249
Net income (loss)	10,643,271	(2,027,183)
Appropriations for operating expenses	1,387,026	8,739,096
Income after appropriations	$12,030,297	$ 6,711,913

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

National Consumer Cooperative Bank
Statements of Changes in Capitalization Years Ended December 31, 1982 and 1981

	U.S. Treasury Notes/Preferred Stock (Note 10)	Members' Ownership: Common Stock	Members' Ownership: Appropriations for Operations	Members' Ownership: Retained Earnings	Total Capitalization
Balance at December 31, 1980	$ 21,471,432	$ 538,835	$10,126,122	$ 59,178	$ 32,195,567
Proceeds from issuance of common stock	–	5,337,339	–	–	5,337,339
Stock redeemed in loan charge-offs (note 2)	–	(4,160)	–	–	(4,160)
U.S. Government investment	162,798,568	–	–	–	162,798,568
Appropriations recognized as revenue	–	–	(8,739,096)	–	(8,739,096)
Income after appropriations	–	–	–	6,711,913	6,711,913
Balance at December 31, 1981	184,270,000	5,872,014	1,387,026	6,771,091	198,300,131
Proceeds from issuance of common stock	–	102,174	–	–	102,174
Stock redeemed in loan charge-offs (note 2)	–	(148,667)	–	–	(148,667)
Appropriations recognized as revenue	–	–	(1,387,026)	–	(1,387,026)
Income after appropriations	–	–	–	12,030,297	12,030,297
Balance at December 31, 1982	$184,270,000	$5,825,521	$ –	$18,801,388	$208,896,909

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

National Consumer Cooperative Bank
Statements of Changes in Financial Position Years Ended December 31, 1982 and 1981

	1982	1981 (Note 15)
Sources of financial resources		
Operations:		
Income after appropriations	$ 12,030,297	$ 6,711,913
Items which do not use (provide) financial resources:		
Increase in interest receivable	(4,091,870)	(667,857)
Increase (decrease) in liabilities, net	4,144,749	(80,572)
Revenue recognized from appropriations	(1,387,026)	(8,739,096)
Provision for loan losses	2,470,135	5,662,830
Depreciation	185,875	71,881
Resources provided from operations	13,352,160	2,959,099
Issuance of stock	102,174	168,135,907
Decrease in escrow accounts	5,406,662	–
Increase in commitment fees	51,519	17,547
Loan repayments	3,705,658	8,469,223
Class A notes issued for preferred stock	–	184,270,000
Other, net	247,632	–
Total sources of financial resources	22,865,805	363,851,776
Applications of financial resources		
Increase in escrow accounts	–	5,488,969
Loans	24,027,515	54,172,395
Additions to fixed assets	600,265	403,035
Preferred stock redeemed for class A notes	–	184,270,000
Other, net	139,473	19,506
Total applications of financial resources	24,767,253	244,353,905
(Decrease) increase in cash and investments	(1,901,448)	119,497,871
Cash and investments, beginning of year	143,435,250	23,937,379
Cash and investments, end of year	$141,533,802	$143,435,250

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

National Consumer Cooperative Bank
Notes to Financial Statements December 31, 1982

[1]Organization

The National Consumer Cooperative Bank (the "Bank") is a U.S. Government-chartered corporation with government financial interest and representation on the Board of Directors. The Bank provides loans and technical assistance to cooperatives.

[2]Summary of Significant Accounting Policies

Basis of Accounting

The financial statements are prepared on the accrual basis of accounting.

Appropriations by the U.S. Government

During the fiscal years ended September 30, 1979, 1980 and 1981, the U.S. Government appropriated funds for purchase of the Bank's class A preferred stock. This stock was exchanged for class A notes on December 31, 1981.

Appropriations for operating expenses during the Bank's start-up period, net of any lapsed or rescinded appropriations, are non-refundable. On January 1, 1982, the Bank assumed all unliquidated obligations associated with these appropriations. Accordingly, any unexpended appropriations for operations were recognized as revenue during 1982.

Investments

Investment securities are carried at cost. Gains or losses on sales of investments are recognized at the time of sale using the specific identification method and are included in other income.

Loans

Loans are carried at their principal amounts outstanding.

Nonperforming loans are accounted for on the nonaccrual basis. The policy of the Bank is to discontinue the accrual of interest on loans when principal or interest payments are ninety days or more in arrears. Interest previously accrued on such loans is reversed. If, in the opinion of management, the outstanding principal remains collectible, such a loan remains on the books as a "nonaccrual" loan. Interest income on nonaccrual loans is recognized only to the extent payments are received.

Allowance for losses

The Bank follows the allowance method in providing for possible loan losses. The allowance for losses is established by a charge to income as a provision for losses. Charge-offs are debited to the allowance, and all recoveries are credited to it. The determination of the balance of the allowance is based upon management's evaluation of the loan portfolio in conjunction with historical loss experience, portfolio composition and current economic conditions.

Fixed Assets

Fixed assets are carried at cost less accumulated depreciation. Depreciation on items purchased before 1982 was computed on a straight-line basis over five and ten years. In 1982 the Bank began using an accelerated method for new purchases.

Maintenance and repairs are expensed as incurred.

Common Stock

Borrowers from the Bank are required to purchase class B stock in the Bank. The purchase of this stock, and other stock as may be required, may be financed by the Bank. Stock owned by a borrower may be redeemed by the Bank in the case of default.

Income Taxes

The Bank does not pay Federal income taxes on any appropriated funds it receives. The National Consumer Cooperative Bank Act Amendments of 1981 (P.L.97-35) provide that, effective January 1, 1982, the Bank shall be treated as a cooperative and subject to the provisions of subchapter T of the Internal Revenue Code. Section 109 of the Bank Act, as amended, provides that the Bank is exempt from state and local taxes with the exception of real estate taxes.

[3]Investments

Investments consist of securities maturing within 1983, with interest rates varying from 8.22% to 14.5%, as follows:

	1982	1981
Certificates of deposit	$ 12,300,000	$ –
Euro certificates and time deposits	95,057,837	–
Federal funds	25,500,000	–
U.S. Treasury and agency obligations	13,852,983	–
Securities sold under agreement to repurchase	(5,436,800)	–
Securities purchased under agreement to resell	–	142,686,811
	$141,274,020	$142,686,811

Interest expense related to securities sold under agreements to repurchase during 1982 amounted to $1,476,963 and is included in interest earned from investments on the income statement.

[4]Loans and Nonperforming Assets

The following is a table of loans outstanding by category as of December 31, 1982 and 1981:

	1982	1981
Multi-family housing cooperatives:		
Loans to established cooperatives	$12,014,280	$ 6,860,251
Loans to developing cooperatives	46,426,635	31,387,696
	58,440,915	38,247,947
Food, producer and other cooperatives:		
Loans to established cooperatives	15,382,227	14,640,143
Loans to developing cooperatives	1,773,551	1,853,233
	17,155,778	16,493,376
	$75,596,693	$54,741,323

Additionally, and in the normal course of business, the Bank makes loan commitments which are not reflected in the accompanying financial statements. These outstanding commitments total $33,298,014 and $32,095,677 at December 31, 1982 and 1981, respectively.

At December 31, 1982, management internally classified 16 loans aggregating $29,200,000 as less than acceptable credit risk. Twelve loans aggregating $18,700,000 are current as to principal and interest. Three are in nonaccrual status. The other loan was rewritten as to interest due totaling $650,495 payable over 30 years. This interest income has been deferred until payments are received.

Nonaccrual loans are defined as loans for which payments are 90 days or more past due. As of December 31, 1982, the Bank had three nonaccrual loans outstanding, aggregating $10,688,744; whereas at December 31, 1981, the Bank had six nonaccrual loans outstanding aggregating $15,379,325. The effect of these nonaccrual loans on interest income for December 31, 1982 and 1981, were reductions of $1,600,000 and $276,000, respectively. At December 31, 1982, there were no commitments to lend additional funds to debtors whose loans were in nonaccrual status.

[5]Portfolio Risk and Security

The Bank is a long-term lender to consumer cooperatives. On real estate and rehabilitation loans which it finances, it also acts as the permanent lender. Maturities of loans generally range from 20 to 30 years.

As an inherent part of its charter and reason for existence, the Bank, in addition to making loans to established cooperative businesses, extends credit to newer, less established cooperatives. Estimates of repayment abilities of these newer developmental entities are generally less reliable than estimates of repayment abilities of existing cooperatives. In these instances, the Bank seeks to protect its interests by increasing collateral requirements, loan guarantees, etc.

The Bank's commercial and real estate portfolio are generally quite diverse. The Bank, however, has loaned money in excess of five million dollars to each of five cooperatives totaling approximately $37 million. One of these is FHA-insured; one has been current since inception; one has been current since inception but is currently in work-out status; one is restructured and current since restructure; and one is nonaccrual and in work-out status. The latter three loans were classified internally by management as less than acceptable credit risk at December 31, 1982.

The Bank only makes unsecured loans to its most creditworthy borrowers. In securing loans, collateral taken includes both first and junior real estate mortgages, inventory, equipment, accounts receivable and other assets. In certain instances, the Bank holds a junior position only, however, these positions are considered adequate to collateralize the debt outstanding.

[6]Affiliations of the Board of Directors

Section 103 of the National Consumer Cooperative Bank Act as amended, requires that twelve of the fifteen members of the Bank's Board of Directors be elected by holders of class B and C stock and that they have actual cooperative experience. Bank stock is, by law, sold only to borrowers and entities eligible to borrow. Thus, in the normal course of business, members of the Bank's Board of Directors may be affiliated with cooperatives receiving or eligible to receive loans from the Bank. The Bank has strict conflict of interest rules which require, among other things, that a Board member be totally disassociated from decisions which pose a conflict of interest or the appearance of a conflict of interest.

Loan requests from cooperatives with which members of the Board of Directors may be affiliated are subject to the same eligibility and credit criteria, as well as the same loan terms and conditions, as all other loan requests.

[7]Allowance for Possible Loan Losses

Provisions for possible loan losses are charges against earnings needed to maintain the allowance for possible loan losses at a level consistent with management's assessment of the risk inherent in the loan portfolio. Factors considered in this assessment include industry concentration, individual loan size, portfolio quality and projected economic conditions. The following summarizes the changes in the allowance for possible loan losses.

	1982	1981
Balance at beginning of year	$6,049,563	$ 437,849
Add: Provision for possible losses	2,470,135	5,662,830
	8,519,698	6,100,679
Deduct: Net charge-offs	107,787	51,116
	$8,411,911	$6,049,563

The allowance for possible loan losses as a percentage of loans outstanding at both December 31, 1982 and 1981, was 11.1%.

The Consumer Cooperative Development Corporation (CCDC), formerly the Bank's Office of Self-Help Development and Technical Assistance, at times makes loans to the same consumer cooperatives as the Bank. In such cases, losses and related provisions are charged to CCDC first and then to the Bank.

[8]Fixed Assets

Fixed assets consist of the following:

	1982	1981
Furnishings and equipment	$ 829,639	$613,018
Leasehold improvements	417,414	44,035
Other	14,533	8,415
	1,261,586	665,468
Less: Accumulated depreciation	273,031	89,118
	$ 988,555	$576,350

[9]Operating Leases

Expenses for leases were as follows:

	1982	1981
Office space	$697,676	$439,985
Telephone system	20,016	—
Word processing and other equipment	165,373	145,735
	$883,065	$585,720

The Bank leases its premises in Washington, D.C., under a noncancellable 10-year operating lease expiring May 14, 1992. The Bank may, at its option, purchase the property on May 15, 1987. Minimum future rental payments under this lease are as follows:

Years ended December 31	
1983	$ 732,568
1984	802,511
1985	824,599
1986	882,026
1987	916,482
After 1987	4,009,611
	$8,167,797

In addition, the Bank leases the premises for eight regional offices. These are all operating leases and may be cancelled with 60 days notice.

The Bank leases a telephone system at its Washington, D.C., offices under an operating lease which expires May 31, 1987, and its word processing equipment under leases that may be cancelled by the Bank with 30 days notice.

[10]Capitalization

U.S. Treasury Class A Notes

On December 31, 1981, the Bank issued unsecured, non-negotiable, class A capital notes to the U.S. Treasury in the amount of $184,270,000 as provided in the Bank Act, as amended, in full redemption of the class A preferred stock previously owned by the Government. The notes and all related payments are subordinated to any secured or unsecured notes and debentures thereafter issued by the Bank, but the notes have first preference with respect to the Bank's assets over all classes of stock issued by the Bank. So long as any class A notes are outstanding, the Bank shall not pay any dividend on any class of stock at a rate greater than the statutory interest rate payable on class A notes.

The notes require that, beginning on December 31, 1981, and ending on December 31, 1990, 30% of the proceeds from the sale of stock, other than classes B or C, be applied to the redemption of the notes. The notes are to be fully repaid, according to a repayment schedule to be established December 31, 1990, not later than December 31, 2020, provided that, beginning October 1, 1990, the proceeds from the sale of classes B and C stock be applied annually toward the repayment of the notes.

The Bank Act states that the amount of Bank borrowing which may be outstanding at any one time shall not exceed 10 times the paid-in capital and surplus of the Bank, which paid-in capital and surplus as defined by the Bank Act includes the amount of the class A notes.

The interest rate, subject to the aforementioned limitation, is determined by the U.S. Treasury on the basis of the average market yield of U.S. obligations of comparable maturity. However, until 1990, the notes entitle the holder to annual interest payments not to exceed 25% of the Bank's gross revenues less necessary operating expenses, including a provision for losses. With the consent of the U.S. Treasury, interest may accumulate in certain circumstances.

Without the approval of the Secretary of the Treasury, the Bank shall not pay any dividend or distribution on, or make any redemption or repurchase of, any class of stock at any time when the deferred interest payments on class A notes shall not have been paid in full, together with any unpaid interest on such notes.

Interest expense on these notes in 1982 amounted to $3,547,757, for an effective rate of 1.93%, and was subject to the 25% earnings limitation discussed above.

Common Stock

The Bank's common stock consists of class B stock owned by borrowers from the Bank, class C stock owned by cooperatives eligible to borrow from the Bank, and class D non-voting stock owned by others.

The Bank's common stock consists of the following:

	1982			1981		
	Class B	Class C	Class D	Class B	Class C	Class D
Par value per share	$100	$100	$100	$100	$100	$100
Shares authorized	100,000	100,000	200,000	100,000	100,000	200,000
Shares issued and outstanding	9,421	48,831	4	8,817	49,900	3

[11]Savings Plan and Retirement Plan

The Bank's total contribution and expense for its savings plan is $189,624 in 1982 and $111,693 in 1981. Total contribution and expense for the Bank's retirement plan is $220,221 in 1982 and $147,111 in 1981.

[12] Income Taxes

The Bank may make deductible patronage refunds in the form of stock or allocated surplus. Patrons of the Bank receiving such refunds consent to include them in their income (see note 2).

[13] Contingent Liabilities

At December 31, 1982, two lawsuits brought by former employees were pending against the Bank. The total exposure of the Bank with regard to these two actions is insignificant.

[14] Transfer of Assets

On December 30, 1982, in accordance with the provisions of the Bank Act, the Bank transferred certain assets, totaling $24,101,603, to a new corporation, the Consumer Cooperative Development Corporation. This new corporation was established on December 30, 1982, under the laws of the District of Columbia, as a non-profit corporation without capital stock for the purpose of assuming the functions previously performed by the Bank's Office of Self-Help Development and Technical Assistance.

The financial statements at December 31, 1982, exclude balances and transactions affecting the Consumer Cooperative Development Corporation.

[15] 1981 Financial Statements

The U.S. General Accounting Office examined the Bank's financial statements as of and for the year ended September 30, 1981, and as of and for the three months ended December 31, 1981. Such financial statements included the operating segments later incorporated as the Consumer Cooperative Development Corporation. The accompanying 1981 financial statements have been restated to reflect operations for the year ended December 31, 1981, and to eliminate those segments related to CCDC to be comparable with the 1982 presentation. Adjustments required for such restatements have not been audited.

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