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REPORT TO THE CONGRESS



Examination Of Financial
Statements Of The National
Credit Union Administration
For The Periods Ended
June 30, 1971 And 1972
Limited By Restriction On Access To
Credit Union Examination Records

B-164031(4)

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

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SEPT. 18, 1973



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

B-164031(4)

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

We have examined the financial statements of the National
Credit Union Administration for the periods ended June 30,
1971 and 1972.

We made our examination pursuant to the Federal Credit
Union Act, as amended in 1970 (12 U.S.C. 1752a(f) and 1789).

We are sending copies of this report to the Director,
Office of Management and Budget; the Secretary of the Treasury;
and the Administrator, National Credit Union Administration.

A handwritten signature in cursive script, reading "James B. Axtell", is positioned above the title.

Comptroller General
of the United States

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COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

EXAMINATION OF FINANCIAL STATEMENTS
OF THE NATIONAL CREDIT UNION
ADMINISTRATION FOR THE PERIODS
ENDED JUNE 30, 1971 AND 1972
LIMITED BY RESTRICTION ON
ACCESS TO CREDIT UNION
EXAMINATION RECORDS B-164031(4)

D I G E S T

WHY THE EXAMINATION WAS MADE

GAO is required by law to audit the National Credit Union Administration and to annually audit its related share insurance fund.

This is the report on GAO's initial audit of the Administration's financial statements.

Background

The Federal Credit Union Act, as amended in 1970, removed the Bureau of Federal Credit Unions from the Department of Health, Education, and Welfare and established it as an independent executive branch agency known as the National Credit Union Administration. The Administration's objectives are to promote a national system of cooperative thrift and credit organizations which are financially sound and to provide a Federal system of share insurance to safeguard member savings in credit unions.

The Administration administers its insurance functions under a share insurance fund; it administers its functions of chartering, supervising, and examining credit unions under an operating fund. GAO examined the financial statements of both funds.

OPINION ON FINANCIAL STATEMENTS

Operating fund

In GAO's opinion, the accompanying financial statements of the operating fund present fairly the financial position of the Administration's operating fund at June 30, 1971 and 1972; the results of its operations; and the changes in its financial position for the fiscal years then ended in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States, applied on a consistent basis.

Share insurance fund

The financial statements for the share insurance fund do not show an estimate of the liability which the Administration may incur as a result of problem conditions in insured credit unions.

Because GAO's access to examination reports and related documentation was restricted, it could not determine (1) whether credit union examinations were of sufficient scope and could be relied on to identify problem credit unions, (2) whether the Administration had taken effective action on

findings disclosed by its examinations, and (3) the significance of any possible adverse effect of problem credit unions on the financial position of the insurance fund.

In addition, GAO could not express an opinion on the reasonableness of the amounts shown on the financial statements for share insurance premiums.

Insured Federal and State-chartered credit unions must pay share insurance premiums on or before January 31 for insurance on member accounts for a calendar year. These premiums are recognized as income in the fiscal year in which they are received and are not deferred to provide a proper matching of revenue and expense. If the insurance premiums had been deferred for the 6 months ended June 30, 1971, and the fiscal year ended June 30, 1972, net income for these periods would have been reduced by about \$3,300,000 and \$1,400,000, respectively. (See p. 14.)

Therefore, in GAO's opinion the accompanying financial statements do not present fairly the financial position of the share insurance fund at June 30, 1971 and 1972, and the results of its operations for the 6 months ended June 30, 1971, and for the fiscal year ended June 30, 1972. However, GAO believes the individual amounts shown in the accompanying financial statements for cash with U.S. Treasury, accrued interest receivable, investments in U.S. Government securities, fixed assets, other liabilities, and income from U.S. Government securities are presented fairly and in conformity with the principles and standards of accounting prescribed by the Comptroller General of the United States for executive agencies.

OTHER MATTERS OF INTEREST

GAO was unable to fully discharge its audit responsibilities for the share insurance fund because the Administration restricted access to examination reports and related data on the credit unions it insures.

GAO believes that access to these records is essential because they contain opinions, conclusions, and recommendations of vital importance to the conduct of the Administration's affairs. The Administration believes that these examination reports are confidential and that access to these reports is outside the scope of GAO's audit authority. (See pp. 10 and 11.)

The Administration did not have an internal audit function to examine its activities, so GAO suggested that such a function be established. The Administration told GAO that it recognized the need for such a function and had established one to audit its financial affairs. (See p. 13.)

RECOMMENDATIONS OR SUGGESTIONS

GAO recommends that the Administrator:

- Grant GAO access to all books, documents, files, and other Administration records, including credit union examination reports and related data.
- Defer, each fiscal year, a portion of the share insurance premiums to provide a proper matching of income and expense.

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Administration believes that the examination reports and related data are confidential and that access to them is outside the scope of GAO's audit authority.

After we completed our audit, Administration officials informed us that the Administration would grant GAO access to the "open" section of the examination reports. This section contains financial data on the credit union, any problem areas noted, and a record of action detailing the specific steps to be taken by the credit union to correct any weaknesses or problems.

The officials stated that GAO would not be granted access to the "closed" section of the examination report. This section contains the examiner's comments and views based on observations made during the examination.

The Administrator told GAO that he had requested a ruling from the Department of Justice on GAO's authority for access to the Administration's examination reports and related data.

Administration officials informed

GAO that, subject to the approval of the Office of Management and Budget, they will begin deferring insurance premiums.

MATTERS FOR CONSIDERATION BY THE CONGRESS

This report comments on GAO's inability to fully discharge its audit responsibility because Administration officials restricted access to examination reports, files, and other records on the credit unions it insures.

Both the Administration and GAO feel that the existing statute supports their respective positions. Therefore, an amendment to the Federal Credit Union Act may be necessary to clarify GAO's audit authority. GAO is deferring a recommendation to amend the act until the Department of Justice decides on GAO's authority for access to the desired records.

CHAPTER 1

INTRODUCTION

The Federal Credit Union Act, as amended in 1970, removed the Bureau of Federal Credit Unions from the Department of Health, Education, and Welfare and established it as an independent executive branch agency known as the National Credit Union Administration. The Administration's objectives are to promote a national system of cooperative thrift and credit organizations which are financially sound and to provide a Federal system of insurance to safeguard member savings in credit unions. To meet these obligations, the Administration issues regulations, establishes reporting requirements, and examines the operations of Federal credit unions.

The Administration has a central office in Washington, D.C., and six regional offices in Boston, Harrisburg, Atlanta, Toledo, Austin, and San Francisco.

The Administration's insurance functions are separated from its other functions of chartering, supervising, and examining credit unions. Insurance functions are financed and administered under a share insurance fund; the other functions are administered and financed under an operating fund.

MANAGEMENT AND ADMINISTRATION

The Administrator, National Credit Union Administration, directs the activities of both the operating fund and the share insurance fund. The Administrator, appointed by the President with the advice and consent of the Senate, serves at the pleasure of the President.

A National Credit Union Board acts in an advisory capacity to the Administrator. The Board consists of a Chairman, who serves at the pleasure of the President, and one member from each of the six Administration regions, appointed by the President with the consent of the Senate.

Board members, except the Chairman, serve 6-year terms. Initial appointments were staggered so that one appointment expired at the end of each calendar year. The first appointment expired December 31, 1971.

OPERATING FUND

Under the authority of Public Law 91-206, the Administrator--through chartering, supervising, and examining credit unions--administers all Federal credit unions. The operating

fund receives its funds from Federal credit unions for these services and from the share insurance fund for work related to share insurance.

The Administration collects the following fees from each Federal credit union.

- An initial charter fee to pay part of the costs incurred in determining whether a charter should be issued to a potential Federal credit union.
- An annual supervision fee after each credit union's first year of operation.
- A fee for an annual examination by Administration examiners.

SHARE INSURANCE FUND

A subsequent act of the Congress (Public Law 91-468, Oct. 19, 1970) authorized the Administration to administer a fund for insuring member accounts in Federal credit unions and in State-chartered credit unions which apply and qualify for insurance up to a maximum of \$20,000 per member account. The insurance is comparable to that which the Federal Deposit Insurance Corporation administers for banks and that which the Federal Savings and Loan Insurance Corporation administers for savings and loan associations.

The share insurance fund (1) provides member account insurance, (2) formulates standards and requirements for insured credit unions, and (3) provides for liquidation or other disposition of the assets and liabilities of insolvent, insured credit unions.

The share insurance program is financed by assessments from insured credit unions and from earnings on investments in Government interest-bearing securities. Each insured credit union is required to pay one-twelfth of 1 percent of the total amount of its member share deposit accounts. The fund, structured to be self-supporting, has a \$100 million borrowing authority from the U.S. Treasury for use in unforeseen emergencies. This borrowing authority has not been exercised.

The first 5,097 Federal credit unions were issued insurance certificates on January 4, 1971. Under the law, each Federal credit union must apply for and obtain insurance from the Administration to retain its charter. Share insurance is optional for State-chartered credit unions.

Certain prerequisites must be met for a credit union to qualify for share insurance. Minimum surety bond coverage must be in force, and there is a minimum period for verifying members' accounts. A maximum borrowing authority has also been established for insured credit unions.

The Administrator is required to disapprove any credit union's application for insurance if the credit union's reserves are inadequate, its financial condition and policies are unsafe or unsound, its management is unfit, insurance of its member accounts would otherwise involve undue risk to the fund, or its powers and purposes are inconsistent with promoting thrift among its members and with creating a source of credit for provident or productive purposes.

As of June 30, 1972, 12,011 Federal credit unions and 1,101 State-chartered credit unions had qualified for share insurance. The Administration estimated that at December 31, 1972, shares insured in 14,023 Federal and State credit unions totaled about \$13.8 billion.

After the share insurance program began, the Administration found that about 1,000 Federal credit unions would not qualify for insurance and therefore would face involuntary liquidation and the loss of their charters.

Public Law 92-221, enacted December 23, 1971, to amend the Federal Credit Union Act, provides for 2 years' insurance for those Federal credit unions whose applications for insurance have been disapproved, if such credit unions have made the necessary transfers to their regular reserves as required by the act. If the Federal credit union has not qualified for regular insurance by the end of the 2 years, the Administrator must suspend or revoke its charter. During the 2 years, however, the Administrator has been directed to offer all possible assistance to help those credit unions obtain regular insurance.

The temporary 2-year insurance has been granted to 1,078 Federal credit unions. As of June 30, 1972, 228 of these qualified for the regular insurance and 71 had been liquidated.

CHAPTER 2

EXAMINATION OF FEDERAL AND

STATE-CHARTERED CREDIT UNIONS

The Administration examines Federal credit unions to ascertain their financial condition and compliance with applicable laws and regulations. The Administration also attempts to identify potential problem areas in management and operations and assists in strengthening management. The Administration reported that it conducted 12,279 and 12,953 regular examinations of Federal credit unions in fiscal years 1971 and 1972, respectively.

Although State-chartered credit unions are insured under the share insurance program, the Administration does not anticipate examining them. Instead, it intends to use, to the extent possible, the examination reports and other information furnished by State supervisory agencies or other organizations examining credit unions on their behalf.

The Administration will review these reports to detect any significant deterioration in financial condition, determine compliance with the applicable provisions of the Federal Credit Union Act, and detect any conditions which could adversely affect or cause risk to the insurance fund. If an insured State credit union is found to be jeopardizing the fund, the Administrator has the authority to issue a cease-and-desist order and, if necessary, to terminate insurance.

The regular examination is the principal method the Administration uses to supervise each Federal credit union. The information obtained also helps to determine if the credit union continues to qualify for share insurance.

EARLY-WARNING SYSTEM

A new system called the early-warning system was implemented in May 1972 to supplement the Administration's regular examinations and to serve as a protective device for the insurance fund. The system is designed to aid in identifying federally insured credit unions that might be verging on financial and management difficulties or that are, in fact, experiencing such difficulties.

The system provides for the input of certain financial and management data obtained from examinations or from reports submitted at required intervals by federally insured credit unions. Subsequent data obtained by the examiner or submitted

by the credit union is then electronically compared with the previous data to determine if adverse financial trends have developed or persist. If an adverse trend has developed, the Administration is to try to help the credit union overcome its problems.

At present, federally insured, State-chartered credit unions are not included in the early warning system but are to be added in the future.

CHAPTER 3

RESTRICTION ON ACCESS TO REPORTS

AND RECORDS ON CREDIT UNION EXAMINATIONS

We requested but were denied access to the Administration's reports and related data on credit union examinations which we believe are essential to our review and to the expression of an opinion on the Administration's statements.

In denying us access, the Administrator stated that (1) such access would violate the confidential relationship between the Administration and the Federal credit unions which it supervises and (2) the scope of GAO's authority, in his opinion, does not extend to examination reports.

We agree there is a need for confidentiality. The information provided will be treated in confidence.

GAO's authority and responsibility for auditing the Administration and the share insurance fund is contained in 12 U.S.C. 1752a(f) and 1789 which state:

"The financial transactions of the Administration shall be audited by the General Accounting Office in accordance with the principles and procedures applicable to commercial corporate transactions and under such rules and regulations as may be prescribed by the Comptroller General of the United States. The audit shall be conducted at the place or places where the accounts of the Administration are kept."

Concerning our audit of the share insurance fund, the statute states:

"(b) With respect to the financial operations * * * the Administrator shall--

* * * * *

"(2) maintain an integral set of accounts, which shall be audited annually by the General Accounting Office in accordance with principles and procedures applicable to commercial corporate transactions, as provided by [section 105 of the Government Corporation Control Act.]"

To fully discharge our audit responsibilities under the cited statutes, we must have unrestricted access to such records as we deem necessary to make an independent and objective examination. We must have a comprehensive understanding of all important factors underlying the Administration's decisions and actions that may significantly affect its financial operations and condition.

For example, the reports of the Office of Supervision and Examination are an essential part of the management of the Administration, since they contain important opinions, conclusions, and recommendations. Without full and complete access to these reports and any supporting records, we cannot be sure that all important factors have been made available for our examination, nor are we in a position to evaluate the effectiveness of the examination division's work or the reliability of its efforts.

Because of the restrictions imposed by the Administration, we could not determine (1) if credit union examinations were of sufficient scope and could be relied on to identify problem credit unions, (2) whether the Administration took effective action on findings disclosed by its examinations, and (3) the significance of any possible adverse effect of problem credit unions on the financial position of the insurance fund.

RECOMMENDATION TO THE ADMINISTRATOR OF THE NATIONAL CREDIT UNION ADMINISTRATION

We recommend that the Administrator grant us access to all books, documents, files, and other Administration records, including credit union examination reports and related data, so we can effectively carry out our audit responsibilities.

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The Administrator told us on May 7, 1973, that he had requested a ruling from the Department of Justice on our authority for access to examination reports and related data.

Administration officials informed us on August 15, 1973, that the Administration would grant GAO access to the "open" section of the examination reports. This section contains financial data on the credit union, any problem areas noted, and a record of action detailing the specific steps to be taken by the credit union to correct any weaknesses or problems.

The officials stated that we would not be granted access to the "closed" section of the examination report. This section contains the examiner's comments and views based on observations made during the examination.

We continue to believe that if GAO is to effectively carry out its audit responsibilities, we must have access to the entire examination report prepared by the Administration.

CHAPTER 4

INTERNAL AUDIT

The Congress has recognized the role and usefulness of internal auditing and has made agency management responsible for establishing this element of internal control. The Budget and Accounting Procedures Act of 1950 provides, in part, that:

"The head of each executive agency shall establish and maintain systems of accounting and internal control designed to provide * * * effective control over and accountability for all funds, property, and other assets for which the agency is responsible, including appropriate internal audit * * *."

The Administration did not have an internal audit function to examine its activities, so we suggested that such a function be established. We believe that an internal audit function would strengthen the internal control system for financial transactions and insure that all the Administration's policies and procedures are followed effectively, efficiently, and economically.

On May 17, 1973, the Administrator informed us that the Administration recognizes the need for such a function and had established one to audit its financial affairs.

CHAPTER 5

COMMENTS ON THE FINANCIAL STATEMENTS

SHARE INSURANCE PREMIUMS

Insured Federal and State credit unions are required to pay share insurance premiums on or before January 31 of each year. These premiums entitle the credit unions to share insurance for a calendar year. The Administration recognizes the premiums as income in the fiscal year in which they are received. Since the Administration's accounts are maintained on an accrual basis and are kept on a fiscal year basis, only one-half of the premiums received in January apply to the fiscal year ended June 30.

If the insurance premiums had been deferred for the 6 months ended June 30, 1971, and the fiscal year ended June 30, 1972, net income would have been reduced by about \$3,300,000 and \$1,400,000, respectively.

Recommendation to the Administrator

We recommend that a portion of the share insurance premiums be deferred each fiscal year to provide a proper matching of income and expense.

- - - -

Administration officials informed us that, subject to the approval of the Office of Management and Budget, they plan to make the suggested adjustment to defer insurance premiums.

ALLOCATION OF COSTS TO THE SHARE INSURANCE FUND

Certain costs incurred by the Administration--such as personnel salaries and benefits, transportation of people and goods, depreciation, rent, and communications--benefit both the operating fund and the share insurance fund. Since some of these costs cannot be directly attributed to either fund, it is necessary to develop procedures to allocate these costs. Since the share insurance fund was established, the Administration has tried to develop such procedures.

During the 6 months ended June 30, 1971, and during fiscal year 1972, the Administration used several different methods to allocate costs to the share insurance fund. The Administration advised us that it used the different methods in an attempt to develop an equitable method. Because

different methods were used and because we were unable to verify the basis used to make certain allocations, we could not determine if the operating expenses shown on the statement of income and expense of the share insurance fund were fairly stated.

The Administration does not believe that the costs allocated to the share insurance fund were excessive because limited charges for overhead were made. The Administrator stated that:

"* * * The test of time has brought no adjustments, upwards or downwards, to charges previously made to the Share Insurance Fund. Therefore, while the basis for verification in the periods audited is lacking in GAO's opinion, we submit that the charges made do fairly present the operating expenses of the Share Insurance Fund."

The Administration said that, after testing various methods, it feels an equitable method has been developed which it will use in fiscal year 1973 to assign costs to the share insurance fund.

ESTIMATED LIABILITY FOR PROBLEM CREDIT UNIONS

The financial statements of the share insurance fund do not show an estimate of the liability which the Administration could incur as a result of problem conditions in insured credit unions. The Administrator stated that:

"The draft GAO report is silent as to a recommendation regarding the estimation of a liability and our endeavors to obtain guidance in this area have not been fruitful. For example, our contacts with other Federal regulatory agencies revealed that the same dilemma is shared to the point of concluding that there is no way to fairly estimate such a liability."

Because the Administration did not permit unrestricted access to examination reports and related data, including information on problem credit unions, we could not determine (1) the relationship which might exist between problem credit unions and the estimating of a liability or (2) the problems inherent in estimating such a liability.

CHAPTER 6

SCOPE OF AUDIT

We examined the operating fund's statements of financial condition at June 30, 1971 and 1972, and the related statements of income and expense and of changes in financial position for the fiscal years then ended. We also examined the share insurance fund's statements of financial condition at June 30, 1971 and 1972; the related statements of income and expense and of changes in financial position for the 6 months ended June 30, 1971, and for the fiscal year ended June 30, 1972; and the statement of analysis of the share insurance fund from the fund's inception.

We made our examination in accordance with generally accepted auditing standards. With the exception of a review of credit union examination reports and related data, our examination included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances and appropriate in view of the effectiveness of the system of internal control.

CHAPTER 7

OPINION ON FINANCIAL STATEMENTS

The financial statements in this report (schs. 1 through 7)--except the statements of changes in financial position, the analysis of the share insurance fund, and the notes to the financial statements--were prepared by the Administration and were modified by us to improve their clarity.

The Comptroller General has not approved the Administration's accounting system.

OPERATING FUND

In our opinion, the accompanying financial statements present fairly the financial position of the Administration's operating fund at June 30, 1971 and 1972, and the results of its operations and the changes in its financial position for the fiscal years then ended in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States, applied on a consistent basis.

SHARE INSURANCE FUND

The share insurance fund financial statements do not show an estimate of the liability which the Administration could incur as a result of problem conditions existing in insured credit unions.

Because our access to examination reports and related documentation on insured credit unions was restricted, we could not determine (1) if credit union examinations were of sufficient scope and could be relied on to identify problem credit unions, (2) whether the Administration had taken effective followup action on findings revealed by the Administration's examiners, and (3) the significance of any possible adverse effect of problem credit unions on the financial position of the insurance fund. (See pp. 10 and 11.)

In addition, we cannot express an opinion on the reasonableness of the amounts shown on the financial statements for share insurance premiums because they represent premiums received in the 6 months ended June 30, 1971, and in the fiscal year ended June 30, 1972, for insurance which is provided for calendar years ended December 31. If the insurance premiums had been deferred for the 6 months ended June 30, 1971, the net income for that period would have been reduced by about \$3,300,000. In fiscal year 1972 the net income would have been reduced by about \$1,400,000. (See p. 14.)

Therefore, in our opinion the accompanying financial statements (schs. 4, 5, 6, and 7) do not present fairly the financial position of the share insurance fund at June 30, 1971 and 1972, and the results of its operations for the 6 months ended June 30, 1971, and for the fiscal year ended June 30, 1972. However, we believe the individual amounts shown in the accompanying financial statements for cash with U.S. Treasury, accrued interest receivable, investments in U.S. Government securities, fixed assets, other liabilities, and income from U.S. Government securities are presented fairly and in conformity with the principles and standards of accounting prescribed by the Comptroller General of the United States for executive agencies.

NATIONAL CREDIT UNION ADMINISTRATION

OPERATING FUND

COMPARATIVE STATEMENT OF FINANCIAL CONDITION

JUNE 30, 1972, AND JUNE 30, 1971

<u>ASSETS</u> (notes 1 and 2)		<u>June 30, 1972</u>	<u>June 30, 1971</u>
CURRENT ASSETS:			
Cash:			
With the U.S. Treasury	\$1,015,093	\$1,635,403	
On hand	<u>500</u>	<u>500</u>	\$1,635,903
Accounts receivable		27,827	7,618
Accrued fees:			
Supervision fees	1,087,088	986,884	
Examination fees	<u>155,092</u>	<u>120,962</u>	1,107,846
Travel advances		83,230	37,642
Estimated receivables for examinations in process		<u>101,286</u>	<u>104,202</u>
Total current assets		2,470,116	2,893,211
FIXED ASSETS:			
Equipment	288,983	280,268	
Less accumulated depreciation	<u>123,830</u>	<u>133,782</u>	146,486
OTHER ASSETS:			
Reimbursements due from share insurance fund		<u>635,361</u>	<u>473,626</u>
Total assets		<u>\$3,270,630</u>	<u>\$3,513,323</u>
<u>LIABILITIES AND RETAINED EARNINGS</u>			
CURRENT LIABILITIES (note 3):			
Accounts payable	238,147	233,975	
Accrued liabilities	502,238	406,616	
Liability for advances from other agencies	149,813	775,591	
Liability for accrued leave	<u>659,638</u>	<u>613,577</u>	
Total current liabilities		\$1,549,836	\$2,029,759
OTHER LIABILITIES:			
Liability for agent cashier funds		<u>500</u>	<u>500</u>
Total liabilities		1,550,336	2,030,259
RETAINED EARNINGS:			
Reserve for claims	300,000	300,000	
Current and prior-year earnings	<u>1,420,294</u>	<u>1,183,064</u>	<u>1,483,064</u>
Total liabilities and retained earnings		<u>\$3,270,630</u>	<u>\$3,513,323</u>

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

GAO's opinion on these statements is set forth on page 17.

SCHEDULE 2

NATIONAL CREDIT UNION ADMINISTRATION

OPERATING FUND

COMPARATIVE STATEMENT OF INCOME AND EXPENSE

FOR THE FISCAL YEARS ENDED

JUNE 30, 1972, AND JUNE 30, 1971

	<u>Fiscal year 1972</u>	<u>Fiscal year 1971</u>
INCOME (note 4):		
Charter fees	\$ 9,260	\$ 11,200
Supervision fees	2,266,000	1,967,000
Examination fees	<u>7,121,354</u>	<u>5,726,745</u>
Total income	\$9,396,614	\$7,704,945
OPERATING EXPENSES (note 5):		
Personnel compensation	6,651,112	5,348,494
Personnel benefits	651,029	483,384
Travel	929,524	806,926
Transportation of things	47,486	12,772
Rent and communications	204,181	146,484
Printing and reproduction	109,522	98,358
Other contractual services	389,565	572,837
Supplies and materials	100,905	71,558
Depreciation of equipment	30,000	27,000
Annual leave	<u>46,060</u>	<u>60,500</u>
Total expenses	<u>9,159,384</u>	<u>7,628,313</u>
Net income	\$ <u>237,230</u>	\$ <u>76,632</u>

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

GAO's opinion on these statements is set forth on page 17.

NATIONAL CREDIT UNION ADMINISTRATION

OPERATING FUND

STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR FISCAL YEARS 1972 AND 1971

	<u>1972</u>	<u>1971</u>
FUNDS PROVIDED:		
Income from charter, supervision, and examination fees	\$9,396,614	\$7,704,945
Decrease in net working capital	<u>-</u>	<u>397,400</u>
	<u>\$9,396,614</u>	<u>\$8,102,345</u>
FUNDS APPLIED:		
Operating expenses, excluding depreciation	\$9,129,384	\$7,601,313
Purchase of equipment	48,667	27,406
Increase in amounts due from the share insurance fund	161,735	473,626
Increase in net working capital	<u>56,828</u>	<u>-</u>
	<u>\$9,396,614</u>	<u>\$8,102,345</u>

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

GAO's opinion on these statements is set forth on page 17.

NOTES TO FINANCIAL STATEMENTS

OPERATING FUND

1. The National Credit Union Administration was established in the executive branch as an independent agency by Public Law 91-206, enacted March 10, 1970. The Administration was created as a successor to the Bureau of Federal Credit Unions.
2. Accounting policy: one-half of the supervision fees are estimated by the Administration and are based on management forecasts of Federal credit union growth.
3. These statements do not include accountability for the funds held in trust for unpaid shareholders of liquidated credit unions. These funds, which amounted to \$201,779.74 and \$342,272.71 at June 30, 1971, and June 30, 1972, respectively, are held by the U.S. Treasury.
4. By action of the Administrator, supervision fees for calendar year 1972 were reduced 10 percent, except when the minimum fee is still required by the Federal Credit Union Act.
5. These statements do not include costs incurred by the Administration in completing certain contract work for the Office of Economic Opportunity and the National Association of Housing and Redevelopment Officials. Costs incurred under these contracts amounted to \$253,245.49 and \$159,809.81 in fiscal years 1971 and 1972, respectively. These costs were reimbursed to the Administration with the exception of \$7,618 and \$27,801 which were outstanding at June 30, 1971 and 1972, respectively.

NATIONAL CREDIT UNION ADMINISTRATION

SHARE INSURANCE FUND

STATEMENT OF FINANCIAL CONDITION

JUNE 30, 1972, AND JUNE 30, 1971

<u>ASSETS</u> (notes 1 and 2)		June 30, <u>1972</u>	June 30, <u>1971</u>
CURRENT ASSETS:			
Cash with U.S. Treasury		\$ 403,326	\$ 78,793
Accrued interest receivable		<u>111,886</u>	<u>38,374</u>
Total current assets		515,212	117,167
INVESTMENTS IN U.S. GOVERNMENT SECURITIES		16,178,872	6,277,343
FIXED ASSETS:			
Equipment (note 3)		<u>4,218</u>	<u>-</u>
Total assets		<u>\$16,698,302</u>	<u>\$6,394,510</u>
<u>LIABILITIES AND RETAINED EARNINGS</u>			
OTHER LIABILITIES (note 4):			
Liability to the operating fund		\$ 635,361	\$ 473,626
Liability for advances from another agency (note 5)		<u>504,000</u>	<u>-</u>
Total liabilities		1,139,361	473,626
RETAINED EARNINGS:			
Current and prior years' earnings (sch. 7)		<u>15,558,941</u>	<u>5,920,884</u>
Total liabilities and retained earnings		<u>\$16,698,302</u>	<u>\$6,394,510</u>

The notes following schedule 7 are an integral part of this statement.

GAO's opinion on these statements is set forth on page 18.

SCHEDULE 5

NATIONAL CREDIT UNION ADMINISTRATION

SHARE INSURANCE FUND

STATEMENT OF INCOME AND EXPENSE

FOR THE FISCAL YEAR ENDED JUNE 30, 1972,

AND THE 6 MONTHS ENDED JUNE 30, 1971

	Fiscal year ended June 30, <u>1972</u>	Six months ended June 30, <u>1971</u>
INCOME:		
Share insurance premiums	\$ 9,738,099	\$6,335,508
Income from U.S. Government obligations	<u>496,820</u>	<u>100,585</u>
	10,234,919	6,436,093
OPERATING EXPENSES:		
Salaries and personnel benefits	454,933	431,849
Travel expenses	13,682	12,377
Other administrative expenses	<u>127,472</u>	<u>70,983</u>
Total operating expenses	596,087	515,209
Insurance payments to credit union shareholders	<u>775</u>	<u>-</u>
Total expenses	<u>596,862</u>	<u>515,209</u>
Net income	<u>\$ 9,638,057</u>	<u>\$5,920,884</u>

The notes following schedule 7 are an integral part of this statement.

GAO's opinion on these statements is set forth on page 18.

NATIONAL CREDIT UNION ADMINISTRATION

SHARE INSURANCE FUND

STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR FISCAL YEAR 1972 AND

THE 6 MONTHS ENDED JUNE 30, 1971

	Fiscal year <u>1972</u>	Six-month period ended June 30, <u>1971</u>
FUNDS PROVIDED:		
Insurance premiums	\$ 9,738,099	\$ 6,335,508
Interest on investments	349,849	61,770
Matured U.S. Treasury investments	15,858,522	4,262,981
Increase in amounts owed to the operating fund	161,735	473,626
Advance from the Office of Economic Opportunity	504,000	-
Exchange of U.S. Treasury investments	<u>65,022</u>	<u>-</u>
	<u>\$26,677,227</u>	<u>\$11,133,885</u>
FUNDS APPLIED:		
Purchase of investments	\$25,678,102	\$10,501,509
Operating expenses	596,087	515,209
Insurance payments to credit union shareholders	775	-
Purchase of equipment	4,218	-
Increase in net working capital	<u>398,045</u>	<u>117,167</u>
	<u>\$26,677,227</u>	<u>\$11,133,885</u>

The notes following schedule 7 are an integral part of this statement.

GAO's opinion on these statements is set forth on page 18.

SCHEDULE 7

NATIONAL CREDIT UNION ADMINISTRATION
ANALYSIS OF SHARE INSURANCE FUND
FROM JANUARY 1, 1971, TO JUNE 30, 1972

INCOME:	
Insurance premiums	\$16,084,005
Less insurance rebates to liquidated credit unions	<u>10,398</u>
	16,073,607
Income from U.S. Government securities	<u>597,405</u>
Total income	<u>16,671,012</u>
EXPENSES:	
Operating expenses	1,111,296
Share insurance payments to credit union shareholders	<u>775</u>
Total expenses	<u>1,112,071</u>
Share insurance fund, net income accumulated since inception	<u>\$15,558,941</u>

The notes following schedule 7 are an integral part of this statement.

GAO's opinion on these statements is set forth on page 18.

NOTES TO FINANCIAL STATEMENTS

SHARE INSURANCE FUND

1. The share insurance fund was created by Public Law 91-468, enacted October 19, 1970. Operations of the share insurance fund began January 1, 1971.
2. Accounting policies:
 - U.S. Government securities are presented at amortized cost, which is the purchase price of the securities less the amortized premium or plus the amortized discount. Premiums and discounts are amortized on a straight-line basis from the acquisition date to the maturity date.
 - Share insurance premiums are recognized as income in the fiscal year in which they are received.
3. Accountability for equipment acquired in fiscal year 1972 was transferred to the operating fund in September 1972. No depreciation was taken on this equipment in fiscal year 1972.
4. The Administrator, under authority granted by section 208 of title II of the Federal Credit Union Act, may guarantee the purchase of the loans of insured liquidating credit unions by other organizations to expedite the distribution of assets. These guarantees create a contingent liability on the share insurance fund that is not included in these statements, as follows:

June 30, 1971	\$169,179
June 30, 1972	911,725
- The actual loss to the fund is anticipated to be a relatively small percentage of the total guarantees.
5. The liability of \$504,000 to other agencies arises from an agreement with the Office of Economic Opportunity, which provided the funds to make selected Federal credit unions insurable. This agreement expires June 30, 1973.



NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

Office of the Administrator

OA/LA:mk
May 17, 1973

Mr. H. L. Krieger
Regional Manager
United States General Accounting Office
Washington Regional Office
803 West Broad Street, 5th Floor
Falls Church, Virginia 22046

Dear Mr. Krieger:

In response to your letter of May 2, 1973, I am providing comments on the draft GAO report covering the audit on the examination of financial statements of this agency for fiscal years 1971 and 1972. These comments address the major areas of concern highlighted in your report and constitute our position regarding them. Matters of lesser severity which, in our judgment, would improve the clarity of your draft report are commented upon in the enclosure attached hereto.

Prior to detailing my comments, I wish to express my appreciation for the efforts of your staff in assisting us. As a result of this audit, the first GAO audit of the Share Insurance Fund, many of the recommendations which your staff conveyed during update briefings have improved operations as a result of their adoption. In addition, the positive attitude in which the audit was conducted is evident based on the exchange of views and the opportunity afforded to provide these comments.

. Denial of Unrestricted Access to Examination Reports and Related Data

The relationship between this agency and the Federal credit unions it supervises is one of a confidential nature. Therefore, access to classified examination reports to other than officials of the Federal credit union examined, or authorized agency personnel, violates that relationship. On the other hand, GAO auditors were, in fact, provided with related data which detailed the nature of examinations and supervisory contacts, thereby enabling assessment of the scope of our supervisory procedures and their adequacy for disclosing adverse situations, recommending corrective action, and

minimizing the risk that such adverse situations could have on the Share Insurance Fund. Finally, apart from the foregoing, we do not believe that access to examination reports in any way enhances the benefit of audit since, as you point out (Chapter 3), it is the financial transactions of this agency for which GAO has authority and responsibility and, therefore, the scope of your authority does not, in our opinion, extend to examination reports.

Methods used in assessing the Share Insurance Fund for certain operating expenses benefiting both the Operating Fund and the Share Insurance Fund.

The methods used by this agency to fairly allocate expenses chargeable to the Share Insurance Fund are represented by the changes made to assure fair and legitimate charges. GAO's inability to verify the basis used in allocating these costs, and therefore satisfying itself that the operating expenses of the Share Insurance Fund were fairly stated for the periods audited, forms the basis for their disclaimer in the opinion rendered regarding the Share Insurance Fund. We disagree. The test of time has brought no adjustments, upwards or downwards, to charges previously made to the Share Insurance Fund. Therefore, while the basis for verification in the periods audited is lacking in GAO's opinion, we submit that the charges made do fairly present the operating expenses of the Share Insurance Fund. Nevertheless, while GAO may maintain that appropriate expenses were not assessed, the report should highlight that assessments made were minimal, proper, and certainly not excessive. We believe this fact should be stated in the report since to ignore it may lead the reader to conclude that the Share Insurance Fund was overcharged when, in fact, very limited charges for overhead were made until a proven system could be established. As commented upon in the GAO report (Chapter 5), the method now employed for allocating costs is one which we believe will lend itself to GAO review and verification.

Internal Audit

The comments expressed by GAO (Chapter 4) indicate that we do not plan to institute an internal audit function primarily because of cost ramifications. Such is not the case. We recognize the need for such a function and have already established same to audit annually the affairs of the Division of Financial Management. Our opposition to the GAO recommendation lies in its recommendation to assign such responsibilities to an emerging staff position within

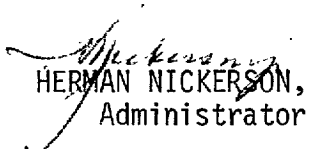
this agency which is not yet staffed nor which was conceived for the purpose of internal auditing of the affairs of our fiscal operations. The establishment of our internal audit function is in keeping with previously-approved action granted by GAO (B-11534 September 23, 1970).

- Financial Statements for the Share Insurance Fund do not reflect an estimate of the liability which the Fund may incur as a result of problem conditions existing in Federally-insured credit unions.

The draft GAO report is silent as to a recommendation regarding the estimation of a liability and our endeavors to obtain guidance in this area have not been fruitful. For example, our contacts with other Federal regulatory agencies revealed that the same dilemma is shared to the point of concluding that there is no way to fairly estimate such a liability. In this regard, we invite your attention to page 884 of the Budget of the United States for fiscal year 1974. As will be noted, the Federal Deposit Insurance Corporation highlights that no provision is made for disbursements which might be made by reason of bank closings because there is no sound basis for predicting which insured banks, if any, will close.

The foregoing concludes the major areas of concern which we request consideration for incorporation in your report to Congress. Should further information be desired, please feel free to contact Assistant Administrator for Administration, Mr. Carroll Smith.

Sincerely,


HERMAN NICKERSON, JR.
Administrator

Enclosure

APPENDIX II

PRINCIPAL OFFICIALS OF THE NATIONAL CREDIT UNION ADMINISTRATION RESPONSIBLE FOR THE ACTIVITIES DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
ADMINISTRATOR:		
Herman Nickerson, Jr.	Sept. 1970	Present
J. Deane Gannon (acting)	Mar. 1970	Sept. 1970
DEPUTY ADMINISTRATOR:		
J. Deane Gannon	Sept. 1970	Present
ASSISTANT ADMINISTRATOR FOR ADMINISTRATION:		
Carroll Smith	Mar. 1970	Present

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