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Mr Garth Marston, Acting Chairman  
Federal Home Loan Bank Board  
320 First Street, NW.  
Washington, D.C. 20552

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Dear Mr. Marston:

We recently completed our examination of the Federal Home Loan Bank Board and Federal Savings and Loan Insurance Corporation's 1975 financial statements. As in past years, we would like to bring to your attention observations made during our audit which will not be included in our report to the Congress. These matters did not affect our opinion on the financial statements and are presented to provide constructive ideas for improving internal accounting controls and operational efficiency.

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The management summary includes suggestions for (1) enhancing the independence of the internal auditors, (2) improving controls over various accounts including imprest fund expenditures; and (3) improving the management of fixed assets and cash. The summary also suggests that the Board consider including GAO opinion on the financial statements in its annual report. All matters included in the management summary have been discussed with Board officials and in many instances corrective action has already been taken.

We wish to express our appreciation for the many courtesies extended to our representatives by Board personnel throughout our examination. We will be happy to discuss the management summary with you or furnish additional information that might assist in your consideration of our observations.

Sincerely yours,

David P. Sorando  
Regional Manager

Enclosure

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ENCLOSURE

EXAMINATION OF  
FEDERAL HOME LOAN BANK BOARD and  
FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION  
CALENDAR YEAR 1975  
MANAGEMENT SUMMARY

U.S. GENERAL ACCOUNTING OFFICE  
WASHINGTON REGIONAL OFFICE  
FALLS CHURCH, VIRGINIA  
AUGUST 1976

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CHAPTER I

GENERAL

OPPORTUNITY TO INCREASE  
INTERNAL AUDITOR'S INDEPENDENCE

In our prior letter to the Chairman, Federal Home Loan Bank Board (Board), dated July 19, 1974, we expressed concern over the Board's plans to make the internal audit group report for administrative purposes to the Director of the Management Systems Division (MSD) within the Office of Management Systems and Administration (OMSA). We stated that for an internal audit group to achieve maximum independence, it should report directly to the highest echelon within an organization and should be organizationally located outside the line management function. The Board, however, proceeded with its reorganization plans to locate the internal audit group within OMSA. In our letter, we encouraged the Board to closely monitor this reorganization to assure that the desired independence of the audit function was achieved.

In the current organization, the Chief Internal Auditor reports to the Director of MSD for administrative purposes. According to the Chief Internal Auditor, all promotions, hirings, travel orders, and purchases for his staff are approved by the Division Director. Furthermore, the internal auditor's reports and management letters are reviewed

and edited by the Director and Deputy Director of MSD before they are released by the Chief Internal Auditor

Based on this organization and our review of the audit function, we believe the internal auditors could lack the necessary independence to objectively audit the Board's and Federal Savings and Loan Insurance Corporation's (FSLIC) operations. To insure the internal auditors' independence, we suggest they be organizationally removed from the line management function and report directly to the Board or an audit committee that is chaired by a Board member.

OFFICE OF FINANCE  
IMPREST FUND EXPENDITURES

The Office of Finance, Federal Home Loan Banks (FHLB's) maintains an imprest fund with a commercial bank to pay for its operating costs. The fund is replenished by pro rata contributions from the Federal Home Loan Banks. Section 522-82 of the Board Annotated Manual requires a yearly budget to be submitted by the Office of Finance for Board approval. Additionally, under this section the Board has the authority to direct disbursements from the fund for payment of other expenses not approved by the budget but deemed appropriate. The Board's General Counsel in a 1974 opinion interpreted these provisions to mean that

"the Board should approve only those budget items that are proper expenses of the Office of Finance and that payment of non-budget expenses should be made only for such expenses that would have been approved if they had been included in the budget."

The General Counsel's opinion concluded that the Board's using of the imprest fund to pay for Board expenses would be an illegal augmentation of congressional funding.

The imprest fund currently is used to pay for FHLB's related expenditures incurred by the Board. However, based on our review of the Internal Audit Branch's workpapers on the audit of the imprest fund, we identified several expenditures which might be considered Board expenses. For example, four employees that are being paid out of the imprest fund are working under the supervision of Board Office Directors. In regard to these payments, the Director of the Office of Finance requested an opinion from the Board's General Counsel concerning the legality of the expenditures. The General Counsel was unable to render an opinion. His argument was that a reasonable case could be made for both the legality or illegality of the expenditures.

We understand that the Office of the FHLB's is in the process of reviewing this matter and other imprest fund expenditures.

In view of the above, we believe the opportunity exists for using the imprest fund to pay for Board expenses in violation of the Bank Act, thus augmenting the Board's congressional spending authorization without proper legislative approval. To preclude this possibility, we suggest that strong administrative controls be established over the use of the

Office of Finance imprest fund The Board should specifically identify, with the assistance of the General Counsel, the types of expenditures that can be paid through the imprest fund

INCLUSION OF GAO'S OPINION  
IN BOARD'S ANNUAL REPORT

The Board's financial statements are published each year in the April issue of the FHLBB Journal. This issue serves as the Board's annual report to the Congress and the industry it regulates. The inclusion in an annual report of an independent auditor's opinion on the financial statements is a widely accepted practice. The auditor's opinion represents an independent party's assessment of the fairness of the financial statements

In December 1975, we received a request from the Director of MSD concerning the feasibility of our completing the 1975 audit by the end of February so that our opinion on the statements could be included in the Board's annual report. Although this request taxed our staff resources, we agreed with it and completed our examination before the deadline.

In March, however, we were informed by the Director of MSD that our opinion on the financial statements would not be included in the Board's annual report because the Board wanted to think about this matter before making a final decision.

We believe the inclusion of our opinion in the annual report would enhance the reliability of the statements and is

consistent with accepted industrywide practice Therefore,  
we suggest that you consider including the GAO opinion on the  
financial statements in future annual reports



## CHAPTER 2

### FEDERAL HOME LOAN BANK BOARD

#### CASH RECEIPTS CONTROL

Financial Management Division (FMD) accounting procedures require schedules of collection and certificates of deposit to be numbered consecutively. In our test of 64 cash receipts transactions, we found 5 schedules of collection that did not comply with this policy. Specifically, four schedules of collections had either incorrect or duplicate numbers; and in one instance the schedule was missing -

We suggest that the current policy on numbering schedules of collections be reemphasized. By enforcing this policy the possibility of irregularities in the cash account is reduced.

#### FIXED ASSETS

##### Need to properly allocate land and building costs

Management control over the new FHLBB building site and construction costs are essential in order to assure that the costs are kept within the estimated amounts and that the costs are properly recorded and allocated in the general ledger.

Currently, the Board's land subaccount of the general ledger "land and building account" includes all land and GSA construction costs to date. The building subaccount is being used to record only non-GSA construction costs.

We suggested to Board officials that the general ledger land and building account be broken out into the following four subaccounts. (1) land--FHLBB building site, (2) building--GSA construction costs; (3) building--non-GSA construction costs, and (4) land--original building site. These changes would properly allocate and control the costs associated with the new building and give FMD a quantifiable basis for determining incurred costs and future depreciation charges.

FMD officials agreed with our suggestion and recently created new accounts which should correct the allocation problem

#### Fixed asset management

One of the most important elements of internal control is the proper segregation of duties, i e , no one person or division should handle all phases of a transaction from beginning to end. Whenever operations are organized in this manner, the work of one division serves as a check on the accuracy of another.

Currently, the Administration Division is responsible for purchasing, maintaining, and controlling, as well as inventorying fixed assets. Although certain checks are provided, the possibility of errors or theft is greatly increased by having the Administration Division responsible for inventorying assets under their control.

We believe the control over the fixed assets could be strengthened by assigning the internal auditors the responsibility for overseeing the annual physical inventory of fixed assets.

Need to improve accountability of  
headquarters fixed assets

District directors are accountable for the safeguarding of furniture, fixtures, and equipment assigned to them; however, division directors at headquarters are not

We suggest that all division directors receive a furniture, fixtures, and equipment report on a semiannual basis and be held accountable for the items assigned to their division. Additionally, the division directors should be required to sign, on a yearly basis, an affirmative statement that all items are accounted for within their division.

We understand that OMSA has taken action to implement our suggestions

Reconciliation of inventory records

Physical inventories of fixed assets should be taken at regular intervals and the results reconciled to the detail inventory listing and the fixed asset general ledger balance. This reconciliation checks the effectiveness of the accounting procedures and provides assurance that all changes have been recognized in the fixed assets account. Differences between the physical count and the accounting records should be

investigated and reconciled to identify errors, losses, or irregularities

The Administration Division takes an annual physical inventory; however, it has not been reconciled to the detail listing or the general ledger in the last 3 years.

We suggest that, in the future, physical inventories be reconciled to the detail inventory listing and to the general ledger

#### Depreciation expense calculation

Depreciation is a period cost representing the decline in value of an asset during a period. The purpose of accounting for asset depreciation is to systematically allocate the cost of an asset over its estimated useful life. Accurate depreciation computations are important since they affect the financial statements' expense and asset balances

During our review of fixed assets, we noticed that FMD computed the Board's depreciation expense once a year on the furniture, fixtures, and equipment automated inventory system. This calculation took into account all furniture, fixtures, and equipment additions and deletions during the previous period. However, a separate manual calculation which did not consider fixed asset deletions was made monthly and entered into the general ledger. By not taking deletions into account the manual calculation caused an overstatement of the expense and accumulated depreciation accounts.

We suggested to Board officials that the furniture, fixtures, and equipment automated inventory system be set up to perform monthly depreciation expense calculations. This would increase the accuracy of the monthly calculations and eliminate the need for a manual calculation. In addition, we further suggested that the general ledger furniture, fixtures, and equipment account be reconciled and brought into agreement with the automated systems records.

The Director of Accounting and Fiscal Operations, FMD, informed us that a new automated system was recently implemented that will perform monthly depreciation expense calculations and that he currently is working on reconciling the system to the general ledger.

#### Deletions of fixed assets

To maintain control over fixed assets, it is advisable that all changes--additions and deletions--be coordinated through one division.

Our audit of fixed assets revealed that both Financial Management Division and the Administration Division make deletions to the furniture, fixtures, and equipment inventory reports with no communication between the two divisions.

We suggested to Board officials that all deletions be coded only by FMD. This can be accomplished by the Administration Division forwarding all deletion authorizations to FMD. This would define the responsibility and improve the efficiency

of the system by properly coordinating deletions between the two divisions. The Director of Accounting and Fiscal Operations, FMD, agreed with our recommendation and informed us that corrective action has been taken in this area.

Documentation of EDP system entries

Good accounting control over EDP system entries dictates that supporting documents be attached to the system's coding sheets. These coding sheets should also be cross-referenced to journal entries and properly filed.

During our review of the accounts payable and fixed assets automated systems, we found coding sheets that did not have supporting documentation attached to them. Additionally, these coding sheets were difficult to locate since they were inconsistently filed and were not cross-referenced to journal entries. We suggested to FMD officials that they establish proper documentation and cross-referencing procedures for the coding sheets.

In a recent discussion with FMD officials, we were informed that the new automated fixed asset system will correct these accounting control weaknesses for both systems.

## CHAPTER 3

### FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

#### CASH

##### Timely deposit of funds

The Insurance Corporation maintains a cash account with the U.S. Treasury for the deposit and disbursement of funds pertaining to its operations. According to Section 4020, Part V, of the Treasury Manual, funds for deposit to the credit of the Treasurer of the United States are to be deposited daily. Adequate internal control over cash transactions also requires that funds be deposited promptly.

In most instances, the Insurance Corporation follows the practice of holding funds until the deposit is at least \$1 million. This often results in cash items remaining on hand for one to several days.

Any delay in depositing checks reduces the controls over cash. Further, undeposited receipts represent idle cash, which is not a revenue-producing asset. Therefore, we suggest that funds be deposited on the date received.

##### Cancellation of noncurrent insurance checks

The Insurance Corporation issues checks drawn on a number of banks around the country. These checks are principally issued as payments on insured accounts in defaulted institutions. A number of these checks have not been cashed--some were issued up to 10 years ago. Each month the

reconciliation of the cash accounts must include these old checks

Checks that have been outstanding for more than 1 fiscal year subsequent to the fiscal year in which they were issued are not current. Therefore, we suggest that action be taken to cancel these checks and establish an appropriate liability account

The Director of Accounting and Financial Operations agreed with our observation and indicated that action is underway to dispose of these checks. -

#### ASSETS ACQUIRED

##### Security of debentures

An adequate system of internal control over securities includes the separation of duties between the custodian and the person maintaining the records of investments. For most FSLIC securities this segregation is achieved by the use of an independent safekeeping agent, either the Treasury or Federal Reserve Bank of New York.

In our review of assets acquired we noted \$16,650 of FHA debentures on hand in the accounting department. These debentures are maintained in a safe which is locked at night but accessible by accounting employees during the day.

We believe the security of these debentures would be enhanced if they were placed in the hands of a custodian. If the Corporation does not wish to utilize a safekeeping



agent for these securities, we suggest they be placed in a fireproof file under the joint control of two or three Corporation officials

LIABILITIES AND RESERVES

Adjustment of "Due to Savers and Stockholders" Account

At the conclusion of the Marshall Savings and Loan Association receivership in 1970 there were a number of claims that had not been paid. As of December 31, 1975, the Insurance Corporation still had an established liability account in the amount of \$67,629 remaining for these claims-- a number of which have been disallowed by the courts.

We suggest that disallowed amounts be closed back to retained net worth.

Approval needed for changes in computing rate of return

Management has the ultimate responsibility for the financial statements of an organization and thus should approve significant accounting policies.

The Office of Finance, Federal Home Loan Banks, manages the Insurance Corporation's investment portfolio. In 1974, the Office of Finance changed the Corporation's method of computing the rate of return on investments. This change was not approved by the Insurance Corporation or the Board's management. Changes in the method of computing the rate of

return affect the amount of income transferred to each association's secondary reserve balance

We suggest that modifications in computing the annual rate of return be formally approved by the Insurance Corporation's management prior to implementation