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Report to the Congress

September 1989

FINANCIAL AUDIT

Federal Home Loan Bank Board's 1988 and 1987 Financial Statements

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GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-114893

September 29, 1989

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

This report presents our opinion on the Federal Home Loan Bank Board's financial statements for the years ended December 31, 1988 and 1987, disclosing that the Bank Board's financial statements present fairly, in all material respects, its financial position and the results of its operations and its cash flows. This report also presents our reports on the Bank Board's system of internal accounting controls and on its compliance with laws and regulations.

Our opinion discusses the effect that the Financial Institutions Reform, Recovery and Enforcement Act of 1989 has on the Bank Board. This legislation, which was signed into law by the President on August 9, 1989, abolishes the Bank Board and, on the date of enactment, provides regulatory and examination authority and functions for federally insured savings and loan associations to the new Office of Thrift Supervision within the Department of the Treasury. The Bank Board's responsibilities to oversee and supervise the Federal Home Loan Banks were transferred to a new, independent agency, the Federal Housing Finance Board.

The Bank Board, under 12 U.S.C. 1438(c)(6), is subject to the audit provisions applicable to wholly owned government corporations, 31 U.S.C. 9105, under which the Comptroller General audits the financial transactions of such corporations. We conducted our audits in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Chairman of the Senate Committee on Banking, Housing and Urban Affairs; the Chairman of the House Committee on Banking, Finance and Urban Affairs; the Director of the Office of Management and Budget; the Secretary of the Treasury; and the Chairman of the Federal Home Loan Bank Board.

Brian P. Crowley for

Charles A. Bowsher
Comptroller General
of the United States

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To the Chairman
Federal Home Loan Bank Board

We have audited the accompanying statements of financial condition of the Federal Home Loan Bank Board as of December 31, 1988 and 1987, and the related statements of income and expenses and retained earnings and statements of cash flows for the years then ended. These financial statements are the responsibility of the Bank Board's management. Our responsibility is to express an opinion on these financial statements based on our audits. In addition to this report on our audits of the Bank Board's 1988 and 1987 financial statements, we are also reporting on our consideration of its system of internal accounting controls and compliance with laws and regulations.

We conducted our audits in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank Board as of December 31, 1988 and 1987, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that the Bank Board will continue as a going concern. As discussed in Note 6 to the financial statements, on February 22, 1989, the Secretary of the Treasury submitted to the Congress the Financial Institutions Reform, Recovery and Enforcement Act of 1989. The legislation, which was signed into law by the President on August 9, 1989, abolishes the Bank Board and, on the date of enactment, provides regulatory and examination authority and functions for federally insured savings and loan associations to the new Office of Thrift Supervision within the Department of the Treasury. The Bank Board's responsibilities to oversee and supervise the Federal Home Loan Banks are transferred to a new, independent agency, the Federal Housing Finance Board. The legislation also dissolves the Federal Savings and Loan Insurance Corporation and transfers its insurance function to a newly-created savings and loan industry insurance fund administered by the Federal Deposit Insurance Corporation. These financial statements do not include any adjustments that might result from this legislation.

This opinion applies only to the Bank Board's financial statements. The Bank Board formulated policies for and supervised the operations of several related organizations, including the Federal Savings and Loan Insurance Corporation. We will be issuing our opinion on the Corporation's financial statements as a separate report.

Brian P. Crowley for

Charles A. Bowsher
Comptroller General
of the United States

May 31, 1989

Report on Internal Accounting Controls

We have audited the financial statements of the Federal Home Loan Bank Board for the years ended December 31, 1988 and 1987, and have issued our opinion thereon. As part of our audits, we made a study and evaluation of the system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. This report pertains only to our study and evaluation of the system of internal accounting controls for the year ended December 31, 1988. Our report on the study and evaluation of internal accounting controls for the year ended December 31, 1987, is presented in GAO/AFMD-88-67, dated August 24, 1988.

The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Bank Board's financial statements. For purposes of this report, we have classified the significant internal accounting controls into the following categories:

- expenditures,
- financial reporting,
- revenue, and
- treasury.

Our study and evaluation included all of the control categories listed above. In addition, we reviewed the Bank Board's 1988 reports issued pursuant to section 2 of the Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512) to determine the existence and status of any internal accounting control weaknesses relevant to financial matters. The Bank Board reported that its systems of internal accounting and administrative controls, taken as a whole, provided reasonable assurance that the required control requirements were being complied with. We considered the report's statements in conducting our study and evaluation and determining the nature, timing, and extent of our audit tests.

The Bank Board's management is responsible for establishing and maintaining an effective system of internal accounting controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system of internal accounting controls are to provide management with reasonable assurance that (1) obligations and costs are in compliance with applicable laws, (2) funds, property, and assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenditures applicable to operations are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over the Bank Board's assets. Because of inherent limitations in any system of internal accounting controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation, made for the limited purpose described in the second paragraph, would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the Bank Board's system of internal accounting controls taken as a whole or on the categories of controls identified in the second paragraph. Our study and evaluation did not disclose any internal accounting control weaknesses which we considered to be material in relation to the financial statements taken as a whole.

Report on Compliance With Laws and Regulations

We have audited the financial statements of the Federal Home Loan Bank Board for the years ended December 31, 1988 and 1987, and have issued our opinion thereon. Our audits were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of compliance with laws and regulations as we considered necessary in the circumstances. This report pertains only to our review of compliance with laws and regulations for the year ended December 31, 1988. Our report on the review of compliance with laws and regulations for the year ended December 31, 1987, is presented in GAO/AFMD-88-67, dated August 24, 1988.

The management of the Federal Home Loan Bank Board is responsible for compliance with laws and regulations. In connection with our audits, we selected and tested transactions and records to determine the Bank Board's compliance with laws and regulations, noncompliance with which could have a material effect on its financial statements.

As part of our audit, we reviewed and tested compliance with provisions of the Federal Home Loan Bank Act of 1932 (12 U.S.C. 1421 et seq.), the Competitive Equality Banking Act of 1987 (12 U.S.C. 226 note), the Prompt Payment Act (39 U.S.C. 3901 et seq.), section 2 of the Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512), and such other laws and regulations as we considered pertinent to the Bank Board. In our opinion, the Bank Board complied with the terms and provisions of laws and regulations for the transactions tested that could have materially affected the financial statements. In connection with our audit, nothing came to our attention that caused us to believe that the Bank Board was not in compliance with the terms and provisions of laws and regulations for those transactions not tested. However, we did note one compliance matter which merits discussion.

As stated in our previous report on the Bank Board's compliance with laws and regulations, the Chairman of the Subcommittee on Federal Services, Post Office, and Civil Service, Committee on Governmental Affairs, United States Senate, requested that, among other items, we examine whether the Bank Board's "actions in divesting itself of certain functions in favor of establishing entities that consider themselves not subject to the title 5 salary limitations are lawful and proper." On September 6, 1988, we issued an opinion (B-226708) to the Chairman concluding that the Bank Board acted improperly in creating the Office of Regulatory Activities, the Office of Finance, and the Federal Asset Disposition Association as entities whose employees are not subject to the salary limitations of title 5 of the United States Code. We stated that employees of those entities should have been appointed as employees of the Bank Board and, thus, as federal employees. The Bank Board's failure to make such appointments constituted a circumvention of the federal civil service laws.

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 affects the entities discussed in our 1987 report. It requires that the Federal Asset Disposition Association be abolished. The act also abolishes the joint and collective offices of the Federal Home Loan Bank System, including the Office of Regulatory Activities, while preserving the Office of Finance. The act establishes the Federal Housing Finance Board as an independent agency to oversee and supervise the operations of the Federal Home Loan Banks. The newly created Board is authorized to fix the compensation of employees without regard to the salary limitations of title 5, although it requires the compensation of Board employees to be comparable with the compensation of employees at the bank regulatory agencies. The act also provides the Board with the authority to delegate to the Banks or a joint office of the Banks the Board's authority for issuing consolidated obligations, the primary function of the Office of Finance.

The compliance matter discussed above was considered in determining the nature, timing, and extent of the audit tests to be applied in our audits and does not affect our opinion on the Bank Board's financial statements.

Financial Statements

Statements of Financial Condition

DECEMBER 31, 1988 AND 1987
(in thousands)

Assets	1988	1987
Cash with U.S. Treasury	$ 2,601	$ 524
Accounts receivable	10,774	8,420
Land and building (Note 1)	44,729	43,919
Furniture, fixtures and equipment (Note 1)	1,058	3,058
Other assets	24	0
Total assets	59,186	55,921
Liabilities		
Accounts payable and accrued liabilities (Note 1)	3,479	844
Employees' accrued annual leave	1,524	1,372
Total liabilities	5,003	2,216
Capital		
Retained earnings	13,153	12,675
Paid in capital	41,030	41,030
Total capital (Note 4)	54,183	53,705
Total liabilities and capital	$59,186	$55,921

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

Statements of Income and Expenses and Retained Earnings

FOR THE YEARS ENDED DECEMBER 31, 1988 AND 1987
(in thousands)

Income	1988	1987
Assessments:		
Federal Home Loan Banks	$10,777	$ 8,071
Federal Savings and Loan Insurance Corporation	30,563	25,603
Rent and miscellaneous other	864	1,487
Total income	42,204	35,161
Expenses		
Personnel compensation	17,739	17,752
Personnel benefits (Note 3)	3,297	2,830
Travel and transportation	1,175	901
Rent, communication, and utilities	4,285	3,057
Depreciation:		
Furniture, fixtures, and equipment	2,000	2,816
Building	999	939
Building maintenance and other services	12,231	7,048
Total expenses	41,726	35,343
Net income	478	(182)
Retained earnings at beginning of year (Note 4)	12,675	12,857
Retained earnings at end of year (Note 4)	$13,153	$12,675

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

Statements of Cash Flows

FOR THE YEARS ENDED DECEMBER 31, 1988 AND 1987
(in thousands)

Operating Activities	1988	1987
Net income (loss)	$ 478	$ (182)
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation	2,999	3,755
Changes in operating assets and liabilities:		
Increase in accounts receivable	(2,354)	274
Increase in other assets	(24)	39
Increase in accrued annual leave	152	250
Increase in accounts payable and accrued liabilities	2,635	(2,068)
Net cash provided by operating activities	3,886	2,068
Investing Activities		
Acquisition of capital assets	(1,809)	(2,293)
Net cash used in investing activities	(1,809)	(2,293)
Financing Activities		
Net cash provided by financing activities	0	0
Net increase in cash	2,077	(225)
Cash at January 1	524	749
Cash at December 31	$ 2,601	$ 524

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

Notes to Financial Statements

DECEMBER 31, 1988 AND 1987

1. Summary of Significant Accounting Policies:

   a. Furniture, Fixtures, and Equipment (FF&E) - FF&E costs at December 31, 1988 and 1987 were $12,368,137 and $12,368,137 less accumulated depreciation of $11,310,404 and $9,310,405, respectively. Depreciation was computed on the straight-line method based on an 11 year useful life. In September 1987 a review of the FF&E policy was made. It was determined that the new policy (which is subject to review) would be that all FF&E up to $5,000 would be expensed and that FF&E over $5,000 would be capitalized and depreciated on the straight-line method over a 4 year useful life. This new policy change resulted in a FF&E reduction of $3,057,732 over a 2-year period -- $2,000,000 in 1988 and $1,057,732 slated for 1989.

   b. Land and Building - These assets are recorded at cost less accumulated depreciation for the building. Cost of land was originally $10,165,227 and is now at $7,101,112 because the parcel of land at 3rd and D Streets, N.W. Washington, D.C. was sold in September 1986. Building costs at December 31, 1988 and 1987, were $47,216,233 and $45,407,226 less accumulated depreciation of $9,588,102 and $8,588,934, respectively. Depreciation for the building is computed on the straight-line method over 50 years.

   c. Accrued Liabilities - Historically, the Bank Board had never accrued expenses for outstanding contract balances since the totals were insignificant compared to total assets. However, since the contract amounts have grown significantly, the Bank Board accrued over $1.6 million in 1988.

   d. Statement of Cash Flows - In November 1987, the Financial Accounting Standards Board issued Statement No. 95, Statement of Cash Flows (SFAS 95). The Bank Board has adopted the provisions of SFAS 95 by presenting the Statement of Cash Flows in place of the Statement of Changes in Financial Position. The Bank Board did not have any material noncash transactions in 1988.

2. Related Parties - The twelve District Federal Home Loan Banks (FHLBanks), together with their member institutions, comprise the primary components of the FHLBank System. In addition, their affiliated organizations -- the Federal Savings and Loan Insurance Corporation (FSLIC), the Office of Regulatory Activities, the Federal Home Loan Mortgage Corporation, the Office of Finance, the Financing Corporation (FICO), and the Neighborhood Reinvestment Corporation assist in carrying out the Bank System's mission. The FHLBank System is governed and regulated by the Federal Home Loan Bank Board (Bank Board), which is an independent Federal agency in the executive branch of government. The Bank Board is the chartering and regulatory authority for the federal savings and loan associations and federal mutual savings banks. Further, the Bank Board, through the FSLIC and FICO, governs and finances the insurance of accounts in savings and loan associations and mutual savings banks. Bank Board expenses are met through assessments from the FHLBanks (25 percent) and the FSLIC (75 percent). This income is recognized as earned monthly; assessment income for the FHLBanks and the FSLIC for 1988 was $10,777,105 and $30,562,625, respectively.

3. Retirement Plan - Approximately 66% of the Bank Board's employees are covered by the Civil Service Retirement System (CSRS), which is currently two-tiered. For employees hired prior to January 1, 1984, the Bank Board withholds approximately 7 percent of their gross earnings. This contribution is then matched by the Bank Board and the sum is transferred to the Civil Service Retirement Fund, from which this employee group will receive retirement benefits.

   For employees hired on or after January 1, 1984, with more than five years of service (not necessarily continuous), the Bank Board withholds, in addition to Social Security withholdings, .94 percent of their gross earnings, but matches such withholdings with a 7 percent contribution. At the point such earnings exceed the FICA maximum wages of $45,000 for 1988, employees covered under this tier of CSRS are required to have 7 percent of their earnings withheld while the agency expense remains a 7 percent contribution. This second employee group will receive retirement benefits from the CSRS along with the Social Security System, to which they concurrently contribute.

   Beginning in January 1987, all employees hired since January 1, 1984, either as new employees or as having less than 5 years of accumulated service (with a break in service over one year) are included in the new Federal Employee Retirement

System (FERS). For such employees the Bank Board withholds .94 percent of their gross earnings and matches those withholdings with a 12.86 percent contribution. This group of employees will receive benefits from the FERS as well as the Social Security System to which they concurrently contribute. The retirement expenses incurred for all plans during calendar years 1988 and 1987 were $1,425,225 and $1,381,947, respectively.

Although the Bank Board funds a portion of pension benefits under both of the above Retirement Systems relating to its employees and makes the necessary payroll withholdings from them, the Bank Board does not account for the assets of either retirement plan nor does it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management for both Retirement Systems and are not allocated to the individual employers. Except for one retired employee who has health insurance through the Bank Board's own health plan, the Office of Personnel Management accounts for all health and life insurance programs for retired federal employees.

4. Capital: Paid-in-capital represents total paid assessments from the Federal Home Loan Banks for the sole purpose of providing funds for the Bank Board's land and building.

	(in thousands) 1988	1987
Retained Earnings at Beginning of Year	$12,675	$12,857
Net Income (Loss)	478	(182)
Retained Earnings at End of Year	13,153	12,675
Paid-in-Capital at Beginning and End of Year	41,030	41,030
Total Capital at End of Year	$54,183	$53,705

5. Litigation - At the end of 1988, various legal actions were pending that involved the Bank Board. Currently, it is not possible to predict the eventual outcome of the various actions. However, it is management's opinion that these claims will not result in liabilities to such an extent that they will materially affect the FHLBB's financial position.

6. <u>Subsequent Event:</u>

<u>Pending Legislation</u> - On February 22, 1989, the Secretary of the Treasury submitted to the Congress the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), which was introduced as Senate Bill S.774 and as House Bill HR.1278. Under FIRREA, the Bank Board would be abolished and the regulation and examination authority and functions would be transferred to a new office within Treasury, while responsibility to oversee and supervise the Federal Home Loan Banks would be transferred to a new independent agency.

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