GGD-77-36
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REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

Audit Of Financial Statements Of The Federal Financing Bank--Fiscal Years 1975 And 1976

The Federal Financing Bank charges interest, including a fee for expenses and contingencies, on its loans to Federal agencies--its only customers. It accumulated profits of $126 million through the end of fiscal year 1976 and will continue to add to them under its present lending practices.

The Bank should transfer accumulated and future profits to the Treasury and should discontinue the practice of adding a fee to the rates it charges on its loans.

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APRIL 27, 1977

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

B-174958

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

This report summarizes the results of our examination of the financial statements of the Federal Financing Bank for fiscal years 1975 and 1976 and other information concerning its operation and financial condition. Public Law 93-224, which established the Federal Financing Bank, makes the Bank subject to the budget and audit provisions of the Government Corporation Control Act (31 U.S.C. 841 et seq). That act requires us to examine the financial transactions of the organizations subject to it at least once every 3 years. This is our first audit report on the Bank pursuant to that provision.

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of the Treasury; and the Chairman, Board of Directors, Federal Financing Bank.

James B. Staats

Comptroller General
of the United States

for the years then ended; and the changes in financial position for the year ended June 30, 1976, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States. (See p. 16.)

Contents

ABBREVIATIONS

DOT	Department of Transportation
DSAA	Defense Security Assistance Agency
GAO	General Accounting Office
GSA	General Services Administration
HEW	Department of Health, Education, and Welfare
HUD	Department of Housing and Urban Development
OPIC	Overseas Private Investment Corporation
REA	Rural Electrification Administratrion
SBA	Small Business Administration

CHAPTER 1

INTRODUCTION

The Federal Financing Bank was created on December 29, 1973, by the Federal Financing Bank Act of 1973 (Public Law 93-224) as a wholly owned Government corporation. The purpose of the act was to (1) assure that Federal and federally assisted borrowings are coordinated with overall Government economic and fiscal policies, (2) reduce the costs of Federal and federally assisted borrowings from the public, and (3) assure that such borrowings are financed in the manner least disruptive to private financial markets and institutions.

In testimony before the House Ways and Means Committee on March 1, 1973, the Treasury's Under Secretary for Monetary Affairs gave the following reasons for introducing the legislation.

> "The pressing need for the Federal Financing Bank Act at this juncture arises from the growing tendency to finance credit programs directly in the securities markets rather than through lending institutions."
>
> * * * * *
>
> "* * * Similar financing arrangements have been proposed for a number of new agencies or programs.
>
> "Federal credit agencies are thus required to develop their own financing staffs, and their abilities to cope with their principal program functions are lessened by the need also to deal with the complex debt management operations essential to minimizing their borrowing costs and avoiding cash flow problems which could disrupt their basic lending programs.
>
> "Borrowing costs of the various Federal agency financing methods normally exceed Treasury borrowing costs by substantial amounts despite the fact that these issues are backed by the Federal Government.
>
> "Borrowing costs are increased because of the sheer proliferation of competing issues crowding each other in the financing calendar,

the cumbersome nature of many of the securities, problems of timing and small size of issues, and the limited markets in which they are sold. Underwriting costs are often a significant additional cost factor due to the method of marketing.

"Under the proposed Federal Financing Bank Act, these essentially debt management problems could be shifted from the program agencies to the Federal Financing Bank. Many of the obligations which are now placed directly in the private market under numerous Federal programs would instead be financed by the bank. The Bank in turn would issue its own securities. The bank would have the necessary expertise, flexibility, volume, and marketing power to minimize financing costs and to assure an effective flow of credit for programs established by the Congress."

The Bank operates as a financing mechanism for the credit programs of other Federal agencies. Instead of the agencies issuing their own securities in the private market, they may borrow funds directly from the Bank. The Bank can finance these loans by (1) borrowing from the Secretary of the Treasury or (2) issuing its own securities to the public. The Secretary is required, upon request, to loan the Bank at least $5 billion but may, at his discretion, lend additional amounts without limit. The act limits the amount of securities that the Bank may have outstanding to the public at any one time to $15 billion.

The act requires the Secretary of the Treasury to act promptly upon receipt of a request for a loan from a Federal agency. He must either grant his approval or advise the agency and the Congress of the reasons for withholding approval. Withholding of approval shall be made in a manner which is not disproportionately detrimental to the functioning of any particular type of Federal program.

Federal agencies subject to the provisions of the act may issue their own securities to the public. However, to insure (1) orderly and coordinated marketing of Treasury and Federal agency obligations and (2) appropriate financial planning, the act requires the agencies to obtain prior approval of the Secretary of the Treasury. The Secretary must approve (1) the method and terms of financing, including rates of interest and maturities, (2) the source of financing, and (3) the timing of financing in relation to market conditions. The Tennessee Valley Authority and the Farmers Home Administration are exempt under the act from obtaining this approval. However, the Tennessee Valley Authority, under its authorizing legislation, is required to have the Secretary approve the time of issuance and the maximum rates of interest on its bonds. The Farmers Home Administration, under the Participation Sales Act of 1966, is also required to have the Secretary's approval to sell any obligation.

The act exempts certain federally sponsored and chartered organizations that are privately owned from using the Bank. (See app. I. A list of the principal agencies or programs eligible to use the Bank is also included in app. I.)

MANAGEMENT

Bank management is vested in the Board of Directors consisting of a Chairman and four members. The act designates the Secretary of the Treasury as Chairman of the Board and provides that the four members be appointed by the President of the United States. The President, instead of appointing specific individuals to be members of the Board, has named the holders of specific positions within the Treasury Department to occupy the Board positions. The Board of Directors authorized establishing six principal positions to supervise Bank operations. The President also created, by Executive Order 11782, dated May 6, 1974, the Federal Financing Bank Advisory Council consisting of eight members. A list of the Board members and Bank officers is included as appendix III. The Bank became operational on May 6, 1974, when the President signed the Executive order appointing the Board of Directors.

The Bank uses the Treasury's facilities and staff in conducting its operations. Most of the personnel are used on a part-time basis.

CHAPTER 2

OPERATIONS

From May 6, 1974, the date it became operational, to June 30, 1976, the Bank awarded loans totaling $32 billion. As of June 30, 1976, the Bank had loans totaling $22.4 billion outstanding to 17 agencies.

As initially envisioned, the Bank was to obtain its funds by selling its securities to the public, although it also had the authority to borrow from the Treasury. When it began operations, the Bank borrowed funds from the Treasury to finance the loans it made to the agencies. On July 23, 1974, the Bank sold its only issue of securities to the public. The issue was for $1.5 billion and matured on March 31, 1975.

A Treasury official estimated that for this issue the Bank paid an interest rate one-fourth to three-eighths of 1 percent higher than the Treasury would have had to pay had the Bank borrowed the funds. Subsequently, the Bank established the policy of borrowing from only the Treasury. In testimony before the Senate Finance Committee on February 10, 1975, the Secretary of the Treasury stated:

> "* * * In the future, I believe that the Bank should borrow from the Treasury rather than going into the market. The Bank's cost of borrowing is somewhat greater than Treasury's and the additional interest costs which result are inappropriate. Moreover, we can already anticipate that large budget deficits projected for fiscal years 1975 and 1976 will put some upward pressure on interest rates. Federal Financing Bank market borrowing would be likely to put somewhat more pressure on rates than the equivalent Treasury borrowing. In order to minimize costs to the Government and the taxpayers, it would thus be prudent for the Bank to borrow from the Treasury."

The Bank functions basically as a conduit for agency borrowing requests. The Treasury borrows the funds needed by the agencies from the public and loans the funds to the Bank which, in turn, loans them to the agencies.

The financing method used by the Bank--borrowing from the Treasury--has the effect of placing Bank borrowing into the public debt subject to the debt limitation because, when the Bank borrows from the Treasury to finance its loans, the Treasury must increase its borrowing from the public. However, if the debt ceiling were in danger of being reached, the Bank could sell its own securities, which are not subject to the debt ceiling.

The direct borrowings of most of the agencies served by the Bank are not classified as part of the public debt.

SATISFACTION WITH THE BANK

We sent questionnaires to all 15 agencies that had outstanding loans from the Bank at June 30, 1975, to obtain an indication of their satisfaction with its operations. The 14 agencies that responded said that they were generally satisfied with the loan arrangements with the Bank, such as the paperwork involved, interest rates charged, interest payment dates, and maturity dates.

SAVINGS TO BORROWING ORGANIZATIONS

We also asked the agencies to estimate their savings by using the Bank. Eleven of the organizations provided such information and stated that it was less costly to use the Bank than to borrow in the private financial markets to finance their programs. The 11 agencies estimated that during fiscal year 1975 they saved about $43 million in interest expenses and about $10 million in administrative expenses.

BUDGET STATUS OF THE BANK

The Bank is an off-budget agency and as such its activities are not included within the unified budget. We have consistently opposed the creation of off-budget agencies principally because the outlays of those agencies are not subject to the same detailed review and control given programs that are in the budget.

The President's Commission on Budget Concepts in 1967 recommended a unified budget concept in which all Government-owned entities were to be included in the Federal budget. The Commission's concept was adopted in 1969.

An important departure from the Commission's recommendations has been the development of off-budget agencies. Since the Commission's recommendations, legislation has been enacted to remove several Federal agencies from the discipline of the overall budget process; including the Export-Import Bank (the first of the off-budget agencies which moved back onto the budget for fiscal year 1977), the Postal Service, the Rural Telephone Bank, the Rural Electrification and Telephone Fund, the Housing for the Elderly or Handicapped Fund, the Federal Financing Bank, the United States Railway Association, and the Pension Benefit Guarantee Corporation.

The existence of major Federal activities of this sort outside the budget is a matter for serious concern. These programs do not have to compete for resources within the same decision framework as is applied to those on-budget, perhaps equally worthwhile, projects. In addition, the magnitude of such off-budget activities is sufficiently large to undermine the credibility and analytical usefulness of the unified budget concept. Thus, we have consistently opposed the creation of off-budget agencies except in the very specific and limited circumstances recognized by the Commission. These conditions were, in effect, that the activity in question be owned and controlled by private parties. In the case of the Bank, these conditions, do not appear to have been met.

Problems Relating to Financing Loan Guarantees

Not only is the Bank's off-budget status worrysome, but its financing of loan guarantees poses additional budgetary problems. The Bank purchases loans guaranteed by on- and off-budget agencies. During fiscal year 1976 the Bank underwrote $6.1 billion in loan guarantees of these agencies. Estimates for this activity in fiscal years 1977 and 1978 are $8.7 billion and $6.0 billion, respectively.

This Bank activity changes the nature of Federal credit programs by substituting direct Government loans for loan guarantees. Direct loans have typically been intended for distribution to those borrowers who could not obtain credit on reasonable terms. Hence, it is a questionable practice to substitute direct loans for another form of credit assistance whose fucntion it is to fill some other purpose.

This practice also results in a loss of controllability over a relatively large amount of direct loan activity. That is, because of the Bank's purchase of guaranteed loans, a large volume of direct loans which would normally be reported at face value in the budget and subject to budgetary control and discipline can be transferred to off-budget status.

Because of these concerns, we believe that the activities of the Federal Financing Bank should be included within the unified budget. We are studying the alternative methods of getting these and other off-budget transactions back in the budget as well as the implications of such on the budget and related programs.

CHAPTER 3

NEED TO REDUCE INTEREST RATES

The Bank has charged interest on its loans exceeding in most instances the rates it paid to borrow funds and, as a result, had accumulated profits of about $126 million through the end of fiscal year 1976. It will continue to accumulate funds exceeding its needs.

One of the purposes of creating the Bank was:

> "To reduce the costs of Federal and federally assisted borrowings from the public."

The Bank's accumulation of funds exceeding its needs prevents the borrowing agencies from obtaining the full benefits of the reduced borrowing costs.

Section 6(c) of the act provides that:

> "The Bank is authorized to charge fees for its commitments and other services adequate to cover all expenses and to provide for the accumulation of reasonable contingency reserves."

The Bank has implemented this provision by adding a fraction of a percent to the interest rate it charges on its loans to cover any expenses and contingencies. From May 6 until December 2, 1974, the fee was three-eighths of 1 percent. On December 2, 1974, the Bank reduced the fee to one-fourth of 1 percent and on June 5, 1975, reduced the fee to one-eighth of 1 percent. A Bank official said that the reductions were made because the fee generated more funds than were necessary to cover expenses and contingencies.

It is not clear from the history of the act what contingencies the reserves were expected to cover. The Bank maintains, and we agree, that because the borrowers are all Federal agencies or the loans are guaranteed by Federal agencies, there is little likelihood that the borrower or guarantor can default on a loan. Therefore there is no need to establish a contingency reserve for this purpose. A reserve would be needed to absorb any losses which might occur if the interest that the Bank is required to pay on the funds it borrows were more than the interest charged on its loans to the Federal agencies. As the program operates now, however, a reserve for an interest differential is not needed either.

During most of fiscal year 1975, the Bank obtained its funds through short-term borrowings from the Treasury and one short-term issue of its own to the public. The loans it made to the agencies were of varying maturities at interest rates geared to the maturity of the loans. Under this system, interest paid or accrued could have exceeded the interest charged.

On June 5, 1975, however, the Bank adopted a new system. It paid off all its outstanding short-term borrowings from the Treasury and replaced them with new borrowings with maturities to match the maturities of the Bank's loans to the agencies. The interest rates assigned to the new borrowings by the Bank from the Treasury were based on rates determined by the Treasury, taking into consideration the yield as of June 5, 1975, on outstanding marketable obligations of the United States of comparable maturities. No change was made in the interest rates on the Bank's outstanding loans to the agencies. On loans made by the Bank after June 5, 1975, the maturities on its loans to the agencies and its borrowings from the Treasury are also matched. The interest rates are also matched, except that the Bank adds a fee of one-eighth of 1 percent to cover its expenses.

As of June 30, 1976, the Bank had accumulated a profit of $126 million. Some of this was accumulated because the fees charged by the Bank exceeded its administrative expenses--the Bank had administrative expenses of $302,000 in fiscal year 1975 and $250,000 in fiscal year 1976. Part of the profit was accumulated because the interest paid or payable by the Bank on its borrowings was less than the interest earned on its loans to the agencies.

Also it is Bank policy to invest excess cash in Treasury obligations, and it began to do so in fiscal year 1976. During that year the Bank earned about $2 million on its investment in Treasury special issues. As of June 30, 1976, the Bank had $95.9 million invested in such issues.

HOW EXCESS PROFITS CAN BE REDUCED

The profit that will be realized on loans outstanding as of June 30, 1976, plus the fee added to any new loans and the interest which the bank will receive on its investment in Treasury special issues will further increase the Bank's accumulated profits.

To reduce the further accumulation of unneeded profits and provide the using agencies the full benefit of the interest savings achieved by the Bank, the Bank could discontinue its practice of adding a fee of one-eighth of 1 percent on its new loans. Accumulated and future profits could be returned to the Treasury by declaring dividends.

The major reasons given by Bank officials for maintaining the practice of adding a fraction of a percent to the interest rates it charges on loans are that the Bank needs to

--provide for administrative expenses,

--maintain a contingency reserve in the event that it may have to issue its securities to the public, and

--reimburse the Treasury for marketing risks and costs.

Administrative expenses

Administrative expenses could be provided for by having the Bank at the end of each fiscal year estimate expenses for the following year and withhold that amount from the money to be transferred to the Treasury. This would be preferable to the present method of recovering administrative expenses by adding a fraction of a percent to the interest rate charged on each loan. The amount of the fees charged under this system depends entirely on the size of the loan and its maturity and may have little relation to the costs incurred to make and service the loan.

If the administrative expenses increase to a point where the profit is not sufficient to pay them, a charge to cover such expenses could be levied either through a one-time fee or by billing the using agencies quarterly or annually for each new loan or loan commitment.

Bank sale of securities

The only likely event that would require the Bank to sell its own securities in the market would be if the debt ceiling prevented the Treasury from borrowing to meet the needs of the Bank. The Bank could then sell its own obligations, which are not chargeable to the debt ceiling, to the public.

There would be some risk to the Bank if it ever had to resume issuing its own securities to the public because of its possible inability to match the maturities on such securities with the maturity requirements of the borrowing agencies. If the Bank used this method of financing again it could provide for a contingency for interest rate differentials by charging a fee on the specific loans for which it borrowed in the market.

Treasury risks and costs

Treasury marketing risks occur because the Treasury does not borrow funds to meet the needs of the Bank by issuing specific securities. When required to provide such funds, the Treasury increases its regular borrowings from the public. The maturity of these borrowings will rarely, if ever, match the maturities desired by the agencies borrowing from the Bank. Marketing costs are incurred by the Federal Reserve banks in marketing Treasury securities.

The act requires the Treasury in assigning interest rates on funds loaned to the Bank to consider the current average yield on outstanding marketable U.S. obligations of comparable maturity. No mention is made of a fee for risks assumed by the Treasury in borrowing funds to make the loans to the Bank.

Other agencies that borrow directly from the Treasury--not through the Bank--are not charged by the Treasury for marketing risks or for the costs incurred by the Federal Reserve banks in marketing Treasury obligations.

Treasury borrowings are, for the most part, for a short maturity. Bank loans, on the other hand, are for comparatively longer periods. Interest rates are generally lower for loans of short maturity. Treasury could make as well as lose money on borrowings for financing Bank loans.

CONCLUSIONS

In its first two fiscal years of operation, the Bank accumulated a profit of $126 million. The profit that will continue to be earned on outstanding loans as of June 30, 1976, plus the fee added to any new loans and the interest which the Bank will receive on its investment in Treasury special issues will further increase the Bank's accumulated profits.

There is no need for the Bank to retain accumulated profits. The Bank's administrative expenses are relatively minor and can be covered by yearly income. The Bank as it currently operates has no contingencies for which it must provide.

We believe that accumulated and future cash profits of the Bank should be transferred to the Treasury by declaring dividends.

The amount of profit that will continue to accumulate seems, in the absence of any studies to the contrary, to be more than is needed to reimburse the Treasury for marketing risks and costs. Treasury, over the long run, could have borrowing and loan rate differential gains offsetting losses. Marketing costs, which are not charged to those agencies which borrow directly from the Treasury, would appear to be relatively minor.

We therefore believe that the Bank should reduce profits by discontinuing the practice of adding a fee to the interest rate on future loans.

AGENCY COMMENTS

The Bank agrees that accumulated profits in excess of needs should probably be transferred to the general fund of the Treasury.

The Bank thinks it is imprudent, however, to suspend fees because of marketing risks incurred by the Treasury but admits that it is doubtful that the risks could be measured.

We do not deny that the element of risk exists, but the act establishing the Bank requires the Treasury, in assigning interest rates on funds loaned to the Bank, to consider only the current average yield on oustanding marketable U.S. obligations of comparable maturity. No mention is made of a fee for risks assumed by the Treasury in borrowing funds to make the loans to the Bank. Moreover, Treasury does not charge a fee for such risks when it makes loans directly to Federal agencies.

Treasury borrowings are, for the most part, for a short maturity. Bank loans, on the other hand, are for comparatively longer periods. Interest rates are generally lower for loans of short maturity. Over the long run, Treasury could make, as well as lose money on borrowings for financing Bank loans. But the amount of gain or loss is not measurable.

The Bank is unique in its operation and cannot be compared to any other financial body. As it currently operates, the Bank borrows directly from the Treasury and then makes loans to the agencies at no risk to the Bank. In essence, the Bank serves merely as a conduit for Treasury funds.

If the Bank returns to the market, it would be appropriate for it to accumulate its own contingency reserve since it will bear measurable risks. Even then, however, the portfolio should be evaluated periodically and any excessive reserve paid to the Treasury as a dividend.

The Bank maintains that eliminating the fee and later reimposing it to cover anticipated shortfalls and administrative expenses is contrary to sound financial practices and would create inequalities among the Bank's borrowers.

Time and conditions determine borrowing terms. Those borrowing at a time and under conditions different than others can usually be expected to pay more or less than others. This is not a unique practice but, rather, a normal practice.

At its inception the Bank charged three-eighths of 1 percent add-on fee; it later reduced this to one-fourth of 1 percent and then to the present rate of one-eighth of 1 percent. Loans made by the Bank are still outstanding at the old fees while it is making new loans at the one-eighth of 1-percent fee. The monetary needs of the Bank have changed, which has caused the reduction in the fees. We do not believe this is inequitable to the agencies that borrowed from the Bank in the past.

We believe the Bank, in lieu of accumulating money in an amount that cannot now be justified, should discontinue charging a fee and thereby further reduce the costs of borrowing under Federal programs--one of the purposes for establishing the Bank.

RECOMMENDATIONS TO THE CHAIRMAN OF THE BOARD OF DIRECTORS

We recommend that the Bank:

--Transfer accumulated and future cash profits to the Treasury by declaring dividends.

--Discontinue the practice of adding a fraction of a percent to the rates it charges on its loans until studies confirm that the Treasury will, over the long run, incur a shortfall because of borrowing and loan rate differentials. If the Bank returns to the market, then it would be appropriate for it to accumulate its own contingency reserve since it will bear the risks. Even then, however, the portfolio should be evaluated periodically and any excessive reserve paid to the Treasury as a dividend.

--Estimate its following year's expenses and withhold this amount from the profits to be transferred to the Treasury as a dividend. If the expenses should exceed the profits, the difference should be recovered by a quarterly or annual charge to the borrowing agencies for each new loan or commitment.

CHAPTER 4

SCOPE OF EXAMINATION AND

OPINION ON FINANCIAL STATEMENTS

SCOPE OF EXAMINATION

Our audit of the Federal Financing Bank consisted principally of examining its statements of financial condition at June 30, 1975 and 1976, and the related statements of income and changes in capital. The internal audit staff of the Treasury's Bureau of Government Financial Operations--the cognizant internal audit group--had not performed any work at the Bank; therefore, we made detailed tests of the accounting records. We reviewed the enabling legislation, the system for internal control, and the Bank's policies and procedures. We also sent questionnaires to all organizations that, as of June 30, 1975, had loans outstanding from the Bank. The review was conducted at the Bank in Washington, D.C.

Our audit was made in accordance with generally accepted auditing standards and included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

OPINION ON FINANCIAL STATEMENTS

The financial statements and schedules accompanying this report are essentially the same as prepared by the Federal Financing Bank, with some modifications to improve clarity and provide comparability for 2 years, with the exception of the summary schedule on loans (schedule 6), which we prepared.

The Bank has classified its borrowings ($13.5 billion in fiscal year 1975 and $22.4 billion in fiscal year 1976) from the U.S. Treasury as a liability. (See p. 17.) However, under the accounting principles and standards prescribed by the Comptroller General of the United States for Federal agencies, such borrowings should be classified as part of the investment of the United States in the assets of the borrowing agency.

The Bank stated that its classification of the borrowings from the U.S. Treasury as liabilities rather than as part of the investment of the U.S. Government was based on the Bank's following the procedure prescribed by the Treasury "Fiscal Requirements Manual" (II TFRM 4140.1 and app. 1).

The manual establishes a unified system of central accounting and reporting and is issued under the authority of title 31, section 66b(b), United States Code. However, it is required by 31 U.S.C. 66b(c) to be consistent with the principles, standards, and related requirements prescribed by the Comptroller General.

Efforts are being made to resolve this difference in prescribed requirements. In the meantime, the Treasury has advised us that the Bank will modify its accounting procedures to conform to the Comptroller General's principles and standards. (See app. II.)

In our opinion, except for the classification of borrowings from the Treasury discussed above, the accompanying financial statements (schedules 1 through 4) present fairly the financial position of the Bank at June 30, 1975 and 1976; the results of its operations for the years then ended; and the changes in financial position for the year ended June 30, 1976, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States.

 SCHEDULE 1

FEDERAL FINANCING BANK

(A WHOLLY OWNED FEDERAL GOVERNMENT CORPORATION)

COMPARATIVE STATEMENT OF FINANCIAL CONDITION

JUNE 30, 1976 AND 1975

ASSETS	June 30, 1976	June 30, 1975
	(000 omitted)	
Funds with the U.S. Treasury	$ 816	$ *
Federal Security Holdings (from schedule 5)	95,859	0
Loans	22,411,098	13,300,404
Accrued interest receivable	543,200	297,701
Accrued interest purchased	0	2,915
Accrued commitment fees	0	31
Total assets	$23,050,973	$13,601,051
LIABILITIES		
Borrowings from the Secretary of the Treasury	$22,413,168	$13,466,003
Borrowings from the public (non-interest-bearing matured debt--Bank bills)	75	9,000
Accrued interest payable	511,178	61,903
Accounts payable	0	780
Advances from the public	598	0
Accrued administrative expenses	40	26
Total liabililties	22,925,059	13,537,712
CAPITAL		
Retained earnings	125,914	63,339
Total liabilities and capital	$23,050,973	$13,601,051

*Less than $500.00

Note: The opinion of the General Accounting Office on these statements appears on page 16.

SCHEDULE 2

FEDERAL FINANCING BANK

(A WHOLLY OWNED FEDERAL GOVERNMENT CORPORATION)

COMPARATIVE STATEMENT OF INCOME AND EXPENSE

FOR THE FISCAL YEARS ENDED JUNE 30, 1976 AND 1975

	1976	1975
	(000 omitted)	
OPERATING INCOME:		
Amortized discount on Federal security holdings	$ 2,094	$ 0
Interest on loans	1,409,756	415,241
Fees	0	a/10
Commitment fee income	a/9	a/31
Total operating income	1,411,859	415,282
OPERATING EXPENSES:		
Interest on borrowings	1,349,034	269,776
Amortized discount on securities issued	0	81,905
Administrative expenses	250	302
Total operating expenses	1,349,284	351,983
NET INCOME	$ 62,575	$ 63,299

a/These figures show income from fees for title transfers of Bank securities and a loan commitment. They do not include the income from the fee charged by the Bank for expenses and contingency reserves. The income from the fee expenses and contingency reserves is included in the interest on loan figures.

Note: The opinion of the General Accounting Office on these statement appears on page 16.

 SCHEDULE 3

FEDERAL FINANCING BANK

(A WHOLLY OWNED FEDERAL GOVERNMENT CORPORATION)

COMPARATIVE STATEMENT OF CHANGES IN CAPITAL

FOR THE FISCAL YEARS ENDED JUNE 30, 1976 AND 1975

	FY 1976	FY 1975
	(000 omitted)	
Capital, July 1, 1974		$ 40
July 1, 1975	$ 63,339	
Net income for fiscal year	62,575	63,299
Capital, June 30, 1975		$63,339
June 30, 1976	$125,914	

The opinion of the General Accounting Office on these statements appears on page 16.

 SCHEDULE 4

FEDERAL FINANCING BANK

(A WHOLLY OWNED FEDERAL GOVERNMENT CORPORATION)

CHANGES IN FINANCIAL POSITION

FOR FISCAL YEAR 1976

		(000 omitted)
FUNDS PROVIDED BY:		
Borrowings from the Secretary of the Treasury	$8,947,165	
Net income for the year	62,575	
Total funds provided		$9,009,740
FUNDS APPLIED TO:		
Loans	9,110,694	
Redemption of Federal Financing Bank bills	8,925	
Total funds applied		9,119,619
DECREASE IN WORKING CAPITAL		($ 109,879)

STATEMENT OF CHANGES IN WORKING CAPITAL

FOR FISCAL YEAR 1976

	June 30 1976	June 30 1975	Changes in working capital Increase (Decrease)
	---------(000 omitted)----------		
CURRENT ASSETS:			
Funds with the U.S. Treasury	$ 816	$ *	$ 816
Federal security holdings	95,859	0	95,859
Accrued interest receivable	543,200	297,701	245,499
Accrued interest purchased	0	2,915	(2,915)
Accrued commitment fees	0	31	31
Total current assets	639,875	300,647	
CURRENT LIABILITIES:			
Accrued interest payable	511,178	61,903	(449,275)
Accounts payable	0	780	(780)
Advances payable	598	0	(598)
Accrued administrative expenses	40	26	(14)
Total current liabilities	511,816	62,709	
Working capital	128,059	237,938	
Decrease in working capital			($109,879)

*Less than $500.00.

Note: The opinion of the General Accounting Office on these statements appears on page 16.

 SCHEDULE 5

FEDERAL FINANCING BANK

(A WHOLLY OWNED FEDERAL GOVERNMENT CORPORATION)

FEDERAL SECURITY HOLDINGS

JUNE 30, 1976

Nonmarketable special issues:

Security	Maturity date	Face amount	Less unamortized discount	Book value
		---------(000 omitted)---------		
Bills	7/15/76	$13,785	$ 34	$13,751
Bills	8/19/76	62,860	311	62,549
Bills	9/16/76	19,820	261	19,559
		$96,465	$606	$95,859

SCHEDULE 6

FEDERAL FINANCING BANK

(A WHOLLY OWNED FEDERAL GOVERNMENT CORPORATION)

LOANS AND INTEREST RECEIVABLE

BORROWINGS FROM THE SECRETARY OF THE TREASURY

AND INTEREST PAYABLE (note a)

JUNE 30, 1976

SUMMARY

Agency or program	Guarantor	Loans and borrowings	Accrued interest receivable	Accured interest payable
		-----------(000 omitted)------------		
Department of Agriculture, Farmers Home Administration	-	$8,800,000	$395,963	$369,011
Rural Electrification Administration	REA	948,026	222	218
Rural Electrification Administration--Certificate of Beneficial Ownership	REA	166,374	3,404	3,352
Department of Defense, Defense Security Assistance Agency	DSAA	898,882	9,560	9,408
Export-Import Bank of the United States	-	4,984,600	43,702	42,668
General Services Administration	GSA	68,803	6,872	4,861
Department of Health, Education, and Welfare, Medical Facilities Direct Loan Program	HEW	118,548	0	0
Department of Housing and Urban Development, New Community Development Corporation	HUD	27,500	4531	541
National Railroad Passenger Corporation (Amtrak)	DOT	567,506	13,436	13,112
Overseas Private Investment Corporation	OPIC	5,454	446	214

SCHEDULE 6

FEDERAL FINANCING BANK

(A WHOLLY OWNED FEDERAL GOVERNMENT CORPORATION)

LOANS AND INTEREST RECEIVABLE

BORROWINGS FROM THE SECRETARY OF THE TREASURY

AND INTEREST PAYABLE (note a)

JUNE 30, 1976

SUMMARY

Agency or program	Guarantor	Loans and borrowings	Accrued interest receivable	Accrued interest payable
		-----------(000 omitted)-----------		
Small Business Investment Companies	SBA	$ 70,695	$ 1,475	$ 1,460
Small Business Administration	SBA	164,361	0	0
Student Loan Marketing Association (Sallie Mae)	HEW	400,000	4,767	4,747
Tennessee Valley Authority	-	2,180,000	34,669	33,827
United States Postal Service	-	2,748,000	19,690	19,243
United States Railway Association	DOT	85,249	1,134	1,113
Washington Metropolitan Area Transit Authority	DOT	177,000	7,329	7,387
Total loans outstanding		22,411,098	543,200	511,162
Borrowings from the Secretary		2,070	0	16
Total loans and borrowings		$22,413,168	$543,200	$511,178

a/With the exception of the rate of interest, obligations issued by the Bank to the Treasury will have terms and conditions equivalent to the obligations purchased by the Bank.

Summary was prepared by GAO.

PRINCIPAL AGENCIES OR PROGRAMS

ELIGIBLE TO UTILIZE

THE FEDERAL FINANCING BANK

Farmers Home Administration
National Railroad Passenger Corporation (Amtrak)
Export-Import Bank
Maritime Administration
Department of Housing and Urban Development (public housing)
Department of Housing and Urban Development (urban renewal)
Department of Housing and Urban Development (new community debentures)
United States Postal Service
Rural Telephone Bank
Rural Electrification Administration
Department of Defense (military credit sales)
General Services Administration
Tennessee Valley Authority
Environmental Financing Authority (note a)
Overseas Private Investment Corporation
Department of Health, Education, and Welfare (medical facilities)
Small Business Administration
United States Railway Association
Student Loan Marketing Association
Washington Metropolitan Area Transit Authority

PRINCIPAL AGENCIES OR PROGRAMS

NOT ELIGIBLE TO UTILIZE

THE FEDERAL FINANCING BANK

Federal home loan banks
Federal National Mortgage Association
Banks for cooperatives
Federal land banks
Federal intermediate credit banks

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a/Charter expired July 1, 1975; no longer in existence.

APPENDIX II

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

January 12, 1977

Dear Mr. Lowe:

I am pleased to respond to your letter of November 23, 1976, in which you request our comments on a proposed GAO report to the Congress on the financial audit of the Federal Financing Bank for the fiscal years 1975-1976.

[See GAO note, p. 24.]

Initially, I am concerned with the finding on page ii of the report that the need for the Bank would be "questionable" except for two considerations: (1) that it is "not an active tool of credit management by the Executive Branch"; and (2) that "it serves as a safety valve since the Bank retains the ability to borrow from the public and could do so to meet agency needs in the event the public debt ceiling precluded further Treasury borrowings for these purposes." In my opinion, a more precise statement of the Bank's purpose is set forth in Section 2 of the Federal Financing Bank Act of 1973 and in Chapter I of your report. I also believe that the Bank is carrying out the intent of Congress and fully serving these needs.

Regarding the recommendation that the Bank cease to levy an administrative charge, the Board of Directors of the Bank continues to believe that a fee should be charged and that the fee should be applied to all loans and advances as they are made. The suggested approach of eliminating the charge and later reimposing it to cover shortfalls and administrative expenses is contrary to sound financial practices and would create inequalities among the Bank's borrowers. We would find this method of collection particularly inappropriate in light of the fact that most FFB loans are made to individual guaranteed borrowers rather than to agencies and, therefore, there would be no practicable way of recovering expenses from borrowers financed during the period when fees were not imposed.

Similarly, we would find it imprudent to suspend fees related to the Treasury risk, which you have recognized, "until studies confirm Treasury, over the long run will incur a shortfall because of borrowing and loan rate differentials." The element of risk is present, as it is in any undertaking where loans and borrowings cannot be matched, and this risk must be recognized in advance. It is doubtful that a study could be designed or a "long run period" defined that could separate FFB borrowings from other Treasury undertakings and clearly delineate a gain or loss. But even assuming an acceptable study were completed, it would not deny that the element of risk had existed or furnish a practical means of equitably distributing the gains or recovering the losses from the many FFB borrowers.

In contrast to the other agencies that you have referred to who borrow from the Treasury at what amounts to a subsidized rate, the FFB Act specifically provides for the imposition of fees to cover costs. We believe the application of a fixed percentage charge to each loan or advance is the most equitable method for providing for these costs. It may well develop that the current fee may need to be reduced in the future as it has been twice in the past. Moreover, as we suggested in our earlier letter, accumulated profits in excess of the Bank's reasonable needs should probably be transferred to the general fund of the Treasury.

Regarding the finding that the Bank should classify its borrowing from the Treasury as part of its Federal investment rather than as a liability, it is my understanding that the differences between the requirements of the Treasury Fiscal Requirements Manual and GAO Policy and Procedures Manual are being resolved. The Bank will, of course, modify its accounting procedures to conform to the Comptroller General's principles and standards.

I very much appreciate the opportunity to comment on your proposed report to the Congress.

Sincerely yours,

Robert A. Gerard
Assistant Secretary
(Capital Markets and
Debt Management)

Mr. Victor L. Lowe
Director
General Government Division
United States General Accounting Office
Washington, D. C. 20548

GAO note: Deleted paragraph referred to comments on a GAO report which was never issued. Pertinent comments are dealt with on pp. 9 to 12.

PRINCIPAL OFFICIALS

RESPONSIBLE FOR ADMINISTERING

ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office From	To
BOARD OF DIRECTORS:		
CHAIRMAN:		
SECRETARY OF THE TREASURY:		
William E. Simon	May 1974	Jan. 1977
W. Michael Blumenthal	Jan. 1977	Present
DIRECTORS:		
DEPUTY SECRETARY OF THE TREASURY:		
Vacant	May 1974	July 1974
Stephen Gardner	July 1974	Feb. 1976
Vacant	Feb. 1976	Apr. 1976
George H. Dixon	Apr. 1976	Jan. 1977
Vacant	Jan. 1977	Present
UNDER SECRETARY OF THE TREASURY (MONETARY AFFAIRS):		
Paul E. Volcker	May 1974	June 1974
Jack F. Bennett	July 1974	June 1975
Edwin H. Yeo, III	Aug. 1975	Jan. 1977
Anthony M. Solomon (designated)	Jan. 1977	Present
GENERAL COUNSEL OF THE TREASURY:		
Edward C. Schmultz	May 1974	July 1974
Donald E. Ritger (acting)	July 1974	Aug. 1974
Richard R. Albrecht	Aug. 1974	Jan. 1977
Henry C. Stockell, Jr. (acting)	Jan. 1977	Present
FISCAL ASSISTANT SECRETARY OF THE TREASURY:		
John K. Carlock	May 1974	July 1975
David Mosso	July 1975	Present
OFFICERS:		
PRESIDENT:		
UNDER SECRETARY OF THE TREASURY (MONETARY AFFAIRS):		
Paul E. Volcker	May 1974	June 1974
Jack F. Bennett	July 1974	June 1975

	Tenure of office From	To
Edwin H. Yeo, III	Aug. 1975	Jan. 1977
Anthony M. Solomon (designated)	Jan. 1977	Present
GENERAL COUNSEL:		
GENERAL COUNSEL OF THE TREASURY:		
Edward C. Schmultz	May 1974	July 1974
Donald E. Ritger (acting)	July 1974	Aug. 1974
Richard R. Albrecht	Aug. 1974	Jan. 1977
Henry C. Stockell, Jr. (acting)	Jan. 1977	Present
VICE PRESIDENT AND TREASURER:		
FISCAL ASSISTANT SECRETARY OF THE TREASURY:		
John K. Carlock	May 1974	July 1975
David Mosso	July 1975	Present
VICE PRESIDENT:		
SPECIAL ASSISTANT TO THE ASSISTANT SECRETARY OF THE TREASURY (DEBT MANAGEMENT):		
Edward M. Roob	May 1974	Dec. 1974
Vacant	Dec. 1974	Apr. 1975
Ralph M. Forbes	Apr. 1975	May 1976
Vacant	May 1976	July 1976
John Niehenke	July 1976	Present
VICE PRESIDENT:		
ASSISTANT SECRETARY OF THE TREASURY (CAPITAL MARKETS AND DEBT MANAGEMENT) (note a):		
Robert A. Gerard	May 1976	Jan. 1977
Vacant	Jan. 1977	Present
SECRETARY:		
DIRECTOR, OFFICE OF MARKET ANALYSIS AND AGENCY FINANCE (note b):		
Roland H. Cook	May 1974	Present

a/New position established May 20, 1976.

b/The position was filled by the Assistant to the Special Assistant to the Secretary (Debt Management) from May 24, 1974, to May 20, 1976.

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