



UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

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GENERAL GOVERNMENT
DIVISION

FEBRUARY 28, 1980

B-197390

Mr. Paul H. Taylor
Vice President and Treasurer
Federal Financing Bank



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AGC 00168

Dear Mr. Taylor:

Subject: [Improving Management Controls at the
Federal Financing Bank] (GGD-80-42)

We recently concluded an examination of the Federal Financing Bank's financial statements for fiscal year 1979. Our report to the Congress, which gave an unqualified opinion on those statements, was issued and sent to you on February 6, 1980. However, during this audit we also noted several weaknesses in the Bank's internal controls which, while they do not affect our opinion on the financial statements, need attention.

INTERNAL CONTROL SHOULD BE IMPROVED

The Bank's present internal controls provide reasonable assurance of reliable financial statements, but several improvements need to be made. Specifically

- the accounting system should be documented;
- records and files should be better maintained;
- the accounting staff rotation policy should be revised; and
- most transactions should be computerized.

The accounting system
needs to be documented

One problem we found is that the Bank has few written procedures detailing methods of control, accounting processes, organizational arrangements, or assignments of Bank employees.

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As a general rule, every accounting system should be documented in a manual of instruction. The manual should be comprehensive--not limited to general guidelines or general statements--and should describe such things as: general functions; accounting principles and practices; controls used for receivables, loans, and other assets; and the application of other internal controls, including separation of duties and timely processing of transactions. In addition, the manual should describe the accounting system in detail, display the forms used, state the procedural steps, and illustrate the reports issued.

The Bank does not have such a manual. It does have a chart of accounts and pro-forma journal entries, but these accounting tools are inadequate because employees need statements regarding account content, timing of entries, sources of data, and related subsidiary accounts. Charts that depict the flow of data through principal accounting processes with supplemental descriptions relating actions charted to accounting objectives, records, internal controls, and financial reporting requirements would also be useful.

An attempt to write a manual has been made. In September 1978, after 4 years of operations, the manager of the Trust and Revolving Funds Branch assigned an employee to develop an accounting manual for the Bank. Although scheduled for completion in March 1979, the manual has not been published and apparently little has been accomplished on this assignment.

Documentation is also needed in related areas to strengthen the Bank's accounting system. The Bank does not have documents recording investment policies and procedures or showing types and sources of administrative expenses. Moreover, with many borrowing agencies, the Bank uses various pay back provisions and accounting methods for loans and interest transactions but there is little documentation which shows the various methods and how they are employed.

Records and files should
be better maintained

The records and files system maintained by the Bank was not designed for current or future levels of Bank operations and is in need of more attention.

The Bank should have an accounting system which provides complete and reliable records of operations and accounting transactions. All financial transactions should be adequately supported in files with pertinent documents available for audit and all financial transactions should be readily traceable from originating documents to summary records and financial reports.

At present, the Bank's records are maintained in folders and stored in file cabinets. For each borrowing organization, the Bank maintains a separate file which contains copies of signed loan agreements, promissory notes, memorandums of discussions, loan processing forms, etc. Other files separately house various interest memorandums and journal vouchers necessary to process loan transactions.

The Bank's filing system may no longer enhance Bank operations. The system was designed when the Bank began operations in 1974. Since then, the number of loan transactions and concurrently the volume of loan documents have greatly increased.

Fiscal Year (note a)	Loans receivable (billions)	Percentage increase since 1975	Number of new loan transactions (note b)	Percentage increase since 1975
1975	\$13.3	-	151	-
1976	25.9	195	625	414
1977	35.4	266	839	556
1978	48.1	362	936	620
1979	64.2	483	1,043	691

a/Figures for 1976 encompass the 15-month period, July 1, 1975 through September 30, 1976.

b/Based on Trust and Revolving Funds Branch Work Volume Reports.

The Bank needs to prevent the system from becoming so overwhelmed that records are inaccurate or inaccessible, losing the historical basis for handling future transactions. The Bank's projected growth highlights this need for an organized and streamlined filing system. The services of Treasury records management specialists or an outside organization such as the National Archives and Records Service could be employed to analyze and develop a new, more adequate system.

The Bank also needs to improve its recordkeeping practices. Interest memorandums are not always kept in the same place or in good chronological order. Supporting documentation for journal vouchers is not always in the correct location. Records of administrative expenses are out of date because Treasury personnel do not submit expenses on time and the accounting staff does not follow up. We believe the records are not better maintained because a high priority is not placed on recordkeeping and few staff are available to do the work.

During this audit, we spent far too much time verifying the existence of promissory notes, interest memorandums, journal vouchers, and support for transfers of funds to and from the Bank. This lack of a clear audit trail existed during our last review of the Bank's operations and was discussed with Bank personnel at that time. The internal auditors also noted recordkeeping problems when they reviewed the Bank's 1977 and 1978 operations.

Accounting staff rotation
policy should be revised

The present rotation policy followed by the Trust and Revolving Funds Branch may impair the efficiency of the Bank's staff. We believe that, until other internal controls have been strengthened, the rotation of personnel should be suspended.

The Trust and Revolving Funds Branch, which controls the Bank's accounting function, administers seven major trust funds as well as the Federal Financing Bank fund. Four, full-time staff--two accounting technicians and two operating accountants--manually process the Bank's loans and maintain the accounting records, invest excess capital in Government securities, and prepare Bank-related reports such as quarterly and annual financial statements.

One of the operating accountant positions is a rotating position. We understand the objective of the rotation policy is to increase the familiarity of all participating Branch personnel with the several trust funds the Branch administers. The Branch does not have any written procedures regarding staff rotations; rotations occur from time to time based on management judgment.

While the goal of the rotation policy may be worthwhile to the Branch, from the Bank's perspective it decreases the

continuity and awareness of the Bank's staff, thus damaging accounting operations. Since operations began in 1974, three operating accountants have worked in the rotating position, the latest assigned in March 1979. In our view, rotations combined with (1) an inherently small staff size, (2) potential staff turnover, such as occurred during our audit, and (3) the absence of accounting system documentation; introduce unnecessary inefficiency into Bank operations.

Bank transactions should be computerized

Since the Bank began operations, Bank personnel have discussed and planned some computerization of Bank accounting operations. So far, little progress has been made towards computerization.

Computerization, if planned properly, could provide Bank management more timely information in the format and degree of summarization desired. It could also assist the accounting staff in generating billing letters, budget reports, and statements and free them from the repetitive computations required to process and administer loans. In addition to processing new loans, the accounting staff has to service existing loans. According to Branch personnel, about 2,500 loans were outstanding as of December 31, 1979, which require about 20,000 interest accrual calculations and about 10,000 payment calculations per year. If the Bank continues to grow, this volume will also increase.

Officials within the Trust and Revolving Funds Branch have discussed computer applications for the Bank's accounting operation from the beginning of the Bank's existence. They believe that many accounting duties, such as interest accruals, are repetitive, time-consuming tasks suitable for computerization. In addition, they feel that computerization could speed the reporting process. Measures, such as accruing interest on loans quarterly rather than monthly, have been taken to reduce the accounting workload. However, as the volume of transactions grows, it is increasingly more difficult for the Bank's staff to fulfill their reporting responsibilities on a timely basis.

Due to the low priority given to computerization, little has been accomplished. An outside contractor assessed the needs of the Bank and later proposed a system design. Computer Support and Revolving Funds Branch officials decided that the company's proposal would not meet the needs of the

Bank and terminated the contract. Late in fiscal year 1979 there was a renewed effort to computerize the Bank's accounting operations. One Treasury computer specialist was assigned to determine the computer support needed. The specialist's October 1979 plan proposed a piecemeal approach with complete computer support late in fiscal year 1981. Bank personnel believe that even this tentative completion date is questionable because of a temporary realignment of responsibilities within the Computer Support Branch.

The Bank's computerization effort requires the resolution of both software and hardware questions. For example, the Bank must decide whether to (1) use existing Treasury equipment, (2) have a system compatible with Treasury systems, and (3) expand the scope of the system to include other Bank needs such as interest rate calculations. Although the Bank's Board of Directors has met on only three occasions, the last time in June 1977, we believe the Board could provide some needed direction to the computerization effort. The Board should review the considerable investment that will be required, approve the acquisition strategy, and ensure that the system's output will facilitate management oversight.

Conclusions and recommendations

The Bank's outstanding loans are growing in number and dollar value. Similarly, the time and attention necessary to properly administer the increasing number of loan transactions is straining support systems. To maintain an efficient operation, improvements are needed in internal control procedures. The Bank's accounting system should be documented; the Bank's records and files should be better maintained; and the accounting staffing policy should provide more stability.

According to the manager of the Trust and Revolving Funds Branch, the accounting system, records, and staffing requirements have not been reviewed in more detail because the Bank always expected to computerize accounting operations in the near future. Support requirements, such as the number of staff, for computerized and manual systems would likely vary.

We believe that computerization would be helpful to the Bank's accounting operations. Accordingly, efforts should be increased, with top management oversight, to speed the computerization process. Given the record of slow progress

in computerizing operations, however, we believe that the Bank should not further delay before reviewing and documenting the accounting system, improving the records and files system, and revising staffing procedures. This work should be reviewed and altered as necessary when the system is computerized.

We recommend that you have the Trust and Revolving Funds Branch:

- Present the computerization plans and periodic progress reports for the Board of Directors' review, approval, and oversight.
- Increase the level of effort to speed the computerization of the accounting system.
- Document the accounting system by developing an accounting manual with written policies, procedures, and methods for handling accounts and loan transactions.
- Improve the maintenance and accessibility of the records and files system.
- Suspend the rotation of personnel until the internal controls discussed above are strengthened.

INTERNAL AUDIT

The Bank's Board has adopted bylaws which provide for continuing internal audits of the Bank. In 1977, auditors in the Bureau of Government Financial Operations agreed to make annual internal audits which we could use every 3 years to limit the scope of our audit. We reviewed the 1979 statements in detail before the internal auditors began their work. Although the frequency of internal audits is a decision of the Board, we believe you can avoid duplication by foregoing an internal audit of the 1979 financial statements.

RECOMMENDED CHANGES IN FUTURE FINANCIAL STATEMENTS

At our suggestion, the Bank's accounting staff made several changes in the 1979 financial statements. However, after we completed our work, we noted other ways that future financial statements could be improved. We suggest adding another footnote, as the initial note, to future financial statements

to disclose significant accounting policies such as the method of revenue recognition followed, the method of valuing and reporting receivables and/or payables, and the method of recognition of assets and liabilities relating to unusual transactions. We believe that information about an entity's accounting policies provide financial statement users a fuller understanding of the entity. Therefore, a statement identifying the accounting policies adopted and followed by the Bank should be presented as an integral part of the financial statements.

In the future, the Bank may also want to combine the Statement of Changes in Retained Earnings with the Statement of Income. Separate statements are not needed.

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We discussed these matters with the Manager of the Trust and Revolving Funds Branch and his comments have been incorporated where appropriate.

We are sending copies of this report to other members of the Board of Directors and officers of the Bank.

Thank you for the cooperation and courtesy extended to us during our audit.

Sincerely yours,



Allen R. Voss
Director