

GAO

Report to the Chairman, Committee on
Post Office and Civil Service, House of
Representatives

May 1987

CIVIL SERVICE FUND

Improved Controls Needed Over Investments



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Accounting and Financial
Management Division

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May 7, 1987

The Honorable William D. Ford
Chairman, Committee on Post Office
and Civil Service
House of Representatives

Dear Mr. Chairman:

As you requested, this report describes the results of our review to determine the amount of interest that the Civil Service Disability and Retirement Trust Fund lost because Treasury did not follow its normal investment and redemption policies during the 1984 and 1985 debt ceiling crises.

Our review showed that the fund sustained losses of about \$160 million and that, although Treasury has repaid most of this loss, future losses will occur. Even though legislation was passed giving Treasury authority to restore losses, certain provisions of the law, such as those specifying the dates that should be used in computing losses, restrict its ability to fully reimburse the fund. These future losses could amount to more than \$13 million. The fund also sustained at least \$400,000 in additional losses as a result of internal control weaknesses and errors by Treasury, as well as by the Office of Personnel Management.

As agreed with your office, unless you publicly announce the contents of this report earlier, we will not distribute it until 30 days from the date it is issued. At that time, we will send copies to the Director, Office of Management and Budget; the Director, Office of Personnel Management; interested congressional committees; the Secretary of the Treasury; and other interested parties. Copies will also be made available to others on request.

Sincerely yours,

Frederick D. Wolf
Director

Executive Summary

Purpose

The Department of the Treasury manages the Civil Service Retirement and Disability Fund, which covers 2.8 million active employees and 2 million retirees and their survivors. During fiscal year 1985, the fund received about \$13.2 billion in interest income from its portfolio of securities either issued or guaranteed by Treasury. As of October 31, 1986, the fund's portfolio totaled over \$158 billion. On October 18, 1985, the Chairman, House Committee on Post Office and Civil Service, requested that GAO review allegations about possible irregularities in Civil Service Retirement and Disability Fund investments and make a comprehensive study of the investment policies and practices of the fund. However, because of an ongoing GAO review of Treasury's investment accounting system, the scope of this review was narrowed. It was agreed that GAO's primary objective would be to determine the amount of interest that the trust fund lost because Treasury did not follow its normal investment and redemption policies during periods in 1984 and 1985.

Background

The fund was established in 1920 and is used to fund a retirement plan that covers employees of the executive, judicial, and legislative branches of the U.S. government and the District of Columbia, unless excluded by law or regulation. During fiscal year 1985, the fund, in addition to its \$13.2 billion in interest income, received an additional \$27 billion through employer and employee contributions while paying out \$23 billion to plan participants.

Although the Office of Personnel Management (OPM) is responsible for handling many of the activities affecting the fund, Treasury is legally responsible for fund investments. In fulfilling this responsibility, Treasury's Financial Management Service handles all aspects of the fund's investments. In addition to borrowing from the fund, Treasury also borrows from the public and other trust funds under its care to finance government operations. Treasury's borrowing is constrained by a legal limit (debt ceiling) which restricts the debt that may be outstanding at any one time.

Results in Brief

During 1984 and 1985, Treasury departed from its normal fund management procedures because the government's outstanding debt was at or near the legal limit (referred to as a debt ceiling crisis). These departures from normal procedures resulted in the fund losing about \$160 million in interest earnings. The fund also sustained at least \$400,000 in additional losses as a result of internal control weaknesses and errors by

Treasury as well as by OPM. While Treasury has restored \$160 million in lost interest earnings, GAO estimates that the fund will sustain future losses that could amount to \$13.6 million. These future losses will occur even though legislation was passed giving Treasury authority to restore losses resulting from the debt ceiling crises. This is because certain provisions of the laws, such as those specifying the dates that should be used in computing losses, restrict Treasury's ability to fully reimburse the fund.

Principal Findings

Departure From Normal Procedures

Treasury departed from its normal fund management procedures by delaying investment of fund receipts, prematurely redeeming fund securities, and/or taking other actions in its attempts to manage the government's finances in 1984 and 1985. During those times, the outstanding federal debt was at or near the legal limit, and Treasury took these unusual actions to obtain the cash to pay fund expenses. However, the unintentional consequences of Treasury's actions cost the fund about \$160 million in lost interest earnings. As a result, the Congress enacted legislation to permit Treasury to reimburse the fund. Although the Congress' intent was to fully restore the losses, the legislative language was somewhat restrictive, and the fund's future earnings have been and will be adversely affected. Although it is difficult to estimate the exact amount of the unrestored loss, it could be as much as \$13.6 million unless further legislative action is taken. (See chapter 2.)

Internal Control Weaknesses

GAO also found that the fund incurred losses as a result of internal control weaknesses that allowed errors to occur during the fund's routine operations. These losses were not related to the problems caused by the debt ceiling crises. For example,

- adjustments to the fund's accounting records were generally not documented and did not ensure the accuracy of fund interest earnings, and
- OPM underreported to Treasury amounts to be invested on behalf of the fund.

Treasury cannot restore all losses resulting from such weaknesses, primarily because it is limited by law from making all the necessary adjustments to the fund's records in order to ensure accurate interest earnings. (See chapter 3.)

System Evaluation Lacking

Treasury has not evaluated the system used to account for fund investments for conformance with applicable accounting principles and standards. However, Treasury's procedures for complying with the Federal Managers' Financial Integrity Act call for such an evaluation. This law requires agency heads to annually report to the President and to the Congress the status of their accounting systems' conformance. Had the system been properly evaluated, some of the problems GAO found could have been identified and corrective action initiated. Treasury does not believe that the system is an accounting system, which would make it subject to the Treasury requirements. GAO does not agree with Treasury's position because, among other things, this system is the basis for the trust fund entries made in the Bureau of Public Debt's accounting system. (See chapter 3.)

Recommendations

GAO recommends that the Secretary of the Treasury direct the Financial Management Service to

- determine the amount of unrestored losses resulting from the 1984 and 1985 debt ceiling crises and seek the necessary authority to restore these losses as well as those resulting from the fund's routine operations,
 - establish controls to ensure that the stated redemption policies are followed,
 - properly document adjustments to the accounting records, and
 - evaluate the fund's accounting system for conformance with applicable accounting principles and standards.
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Agency Comments

Treasury generally agrees with GAO's recommendations concerning the need to properly document adjustments and to seek broad legislative authority over investment accounting. The Department did not agree, however, that improved internal controls were needed. GAO believes the Department needs to improve its controls over operations and discusses this issue in chapter 3. OPM also provided comments on the report and agreed that Treasury is the fund manager for investment purposes and that the fund should be made whole for any losses incurred.

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Abbreviations

FFB	Federal Financing Bank
FMS	Financial Management Service
GAO	General Accounting Office
IG	Inspector General
OPM	Office of Personnel Management

Introduction

The Civil Service Retirement and Disability Fund was established by Public Law 66-215, signed May 22, 1920, and has been amended by many subsequent acts of the Congress. It is used to fund a defined-benefit,¹ single employer retirement plan which covers the employees of the executive, judicial, and legislative branches of the U.S. government and the District of Columbia, except those excluded by law or regulation. On September 30, 1985, the plan covered about 2.8 million active employees and 2 million retired employees and survivor annuitants.² Although responsibilities for the fund are shared between the Office of Personnel Management (OPM) and the Department of the Treasury, Treasury is legally responsible for fund investments. Treasury's Financial Management Service handles all aspects of the fund's investments.

Investment and Redemption Policies

According to Treasury and OPM officials, no formal agreement on fund investment and redemption policies exists between the two agencies. However, over the years, an informal policy has evolved which outlines how investments and redemptions will be handled. Treasury is required by law to immediately invest in interest bearing government securities those fund receipts not needed to pay fund expenses. During fiscal year 1985, the plan received about \$13.2 billion in interest income with an additional \$27 billion received through employee and employer contributions. The plan paid about \$23 billion to plan participants during the same period. The fund balance on October 31, 1986, was over \$158 billion and consisted entirely of securities either issued or guaranteed by Treasury.

Investment Policies

Fund receipts are invested in nonmarketable Treasury securities commonly referred to as par value specials and can be redeemed any time at their face value, or "par." The interest rate for these securities is based on the average rate for comparable marketable securities as defined by Treasury, with 4 or more years to maturity. This rate is established on a monthly basis, and all investments for a given month must bear the same rate. Under normal conditions, OPM notifies Treasury of the

¹A defined-benefit plan specifies how the benefits will be determined for employees upon retirement. For example, years of service, salary history, and/or age are used to determine a retiree's benefits.

²The retirement plan offers retirees an option to designate their spouses as the plan beneficiary. If an employee elects this option and dies before the spouse, then the spouse receives the retirement payment at a greatly reduced rate (55 percent or less). Such individuals are referred to as survivor annuitants.

amount to invest and Treasury then makes the investment. Such investments are normally made in short-term, nonmarketable Treasury securities maturing on June 30, which is considered the end of the fund's investment year. On June 30, the surpluses are converted into long-term par value specials with maturities of 1 to 15 years.

Redemption Policies

At the beginning of each month, OPM provides Treasury with an estimate of the funds it will need to pay that month's expenses. Treasury then redeems fund securities based on this information. At the end of each month, OPM provides Treasury with a report on the amount of cash it actually used, and Treasury adjusts its records accordingly. Those securities maturing within the investment year, along with additional investments made during the year, and any accrued interest, are the source of funds used to pay fund expenses.

Under normal procedures, fund benefits are paid by direct deposit to an individual's bank account or by check on the first business day of each month. Because checks take some time to clear, OPM and Treasury have agreed to only redeem securities equal to the amount of benefits paid by direct deposit on the first business day of each month. The securities necessary to pay the benefit checks are usually redeemed on the fourth and fifth business day of the month. This sequencing is designed to allow the fund to earn interest during the average period that benefit checks are outstanding but not cashed (the so-called "float period").

Disruptions in Investments Caused by Debt Ceiling Crisis

Our nation has historically carried debt. In 1789, the federal government began with a debt of about \$78 million. At the end of April 1987, the debt ceiling was \$2.3 trillion. The Congress attempts to control the size of the federal debt by imposing ceilings on the amount of obligations the government can issue.

The securities issued to the Civil Service and other trust funds are normally considered part of the debt subject to the ceiling. However, occasionally, fund receipts have been invested in securities issued through the Federal Financing Bank (FFB).³ FFB securities are not subject to the debt ceiling.

³The FFB was created in 1973 to help ensure that federal and federally assisted borrowings are coordinated. We have determined that FFB's debt is not considered part of the statutory debt ceiling.

On various occasions over the years, normal governmental financing has been disrupted because Treasury had borrowed up to or near the debt ceiling, and legislation to increase the ceiling had not been enacted in a timely manner. We refer to these events as debt ceiling crises because of the prospect of government operations being halted as a result of a lack of financing. The crises also present problems for the various trust funds, since Treasury's inability to borrow funds from the public equates to an inability to invest trust fund receipts. Two debt ceiling crises that affected the fund occurred in 1984 and 1985. The 1984 crisis lasted from September 30, 1984, until October 16, 1984. The 1985 crisis lasted from September 3, 1985, until December 12, 1985. Although fund receipts were available for investment, Treasury did not invest them because it was at or near the debt ceiling. Until legislation was passed which raised the ceiling, Treasury was prevented from legally incurring additional debt.

Objective, Scope, and Methodology

On October 18, 1985, the Chairman, House Committee on Post Office and Civil Service, requested that we review allegations about possible irregularities in Civil Service Retirement and Disability Fund investments and make a comprehensive study of the investment policies and practices of the fund. As agreed with the Chairman's office, we did not perform a comprehensive review of Treasury's investment policies and practices for the fund since this is included in an ongoing GAO review of Treasury's investment accounting system. Therefore, we agreed with the Chairman's office that our primary objective would be to determine the amount of interest that the trust fund lost because Treasury did not follow its normal investment and redemption policies during the 1984 and 1985 debt ceiling crises. On January 23, 1986, we provided the Chairman with an interim letter which supplied our preliminary estimates of interest losses to the fund resulting from Treasury's investment practices and disclosed several issues relating to fund management which we needed to further analyze.

Our review was conducted between October 1985 and September 1986 and was made in accordance with generally accepted government auditing standards. We performed our work in Washington, D.C., at the Department of the Treasury and the Office of Personnel Management. We interviewed agency officials and reviewed the documents necessary to accomplish our objective (for example, Treasury's accounting ledgers and investment and redemption instructions from OPM). We limited our review to the transactions occurring between July 1, 1984, and June 30,

1986. This period was selected because it represented the fund's investment years during which the 1984 and 1985 debt ceiling crises occurred. The specific periods and methodology used for major segments of our work are discussed below.

Estimating Fund Losses

To determine whether the fund incurred any losses as a result of Treasury's actions, we reviewed fund investment and redemption activities and compared them to Treasury's stated procedures. Where it appeared that Treasury did not follow its normal procedures, we compared the fund's actual interest earnings with those that would have accrued had the normal procedures been followed. Treasury officials agreed with our methodology and our estimates of the losses that resulted.

**Accuracy of Treasury's
Investment and Redemption
Data**

In order to assess the accuracy of Treasury's investment and redemption information, we validated the information shown in Treasury's records by comparing them to OPM's requests for investments and redemptions. We selected the period of July 1, 1985, through December 31, 1985, because (1) it covered the period of the latest debt ceiling crisis referred to in the Chairman's letter and (2) the information was readily available. We did not attempt to validate the information OPM provided to Treasury since that was outside the scope of our review. We did, however, rely on a GAO financial audit of the fund for the year ending September 30, 1984.⁴ This audit disclosed no reason to question the amount of fund receipts reported by OPM to Treasury except for OPM's calculation of the year-end special payment. (See chapter 3.)

⁴Financial Audit: Civil Service Retirement System's Financial Statements for 1984 (GAO/AFMD-86-12, April 2, 1986).

Treasury's Departure From Normal Procedures Resulted in Losses to the Fund

We found that during 1984 and 1985, in its attempts to manage the government's finances during the debt ceiling crises, Treasury did not follow its established policies and procedures for investing fund receipts and redeeming the fund's securities. Treasury also took unusual actions during these periods by purchasing Federal Financing Bank (FFB) securities. Three laws were later passed to mitigate the effect of these actions, and Treasury reimbursed the fund about \$160 million for the lost interest earnings. In our view, Treasury has fully complied with these laws. However, because of (1) the methods prescribed in the legislation for restoring the lost interest and (2) the long-term nature of some of the fund investments, additional losses will result in future years. Although the Congress' intent was to fully reimburse the fund for the losses sustained, Treasury does not have the authority to do so.

Equity Between the General Fund and the Trust Funds

Treasury officials have stated that a basic trust fund management policy is to ensure equity between the various trust funds and the general fund—the fund used to pay most government obligations. Assuring that none of the funds unduly benefit from Treasury's management of the funds is sometimes difficult because Treasury is responsible for ensuring that

- the general fund has sufficient cash to finance government operations,
- fund investments and benefit payments to beneficiaries are made on time, and
- the statutory debt limit is not exceeded.

Although there is no inherent conflict among these statutory responsibilities, Treasury has sometimes had difficulty fully meeting them during debt ceiling crises. This was the case at various points in 1984 and 1985, when Treasury was prevented from raising additional cash through borrowing because the amount of debt outstanding was near the statutory debt ceiling and Treasury's operating cash was declining.

Actions Relating to 1984

At the end of September 1984, OPM notified Treasury that it should invest about \$16.3 billion. The majority of this amount was associated with the special year-end fund deposits required by Public Laws 91-93, 93-349, and 98-168.⁵ Treasury did not immediately invest about \$11.8 billion of these receipts because it was nearing the statutory debt ceiling.

⁵These laws specify that year-end payments are to be made to the fund to cover certain specified liabilities.

Treasury gradually invested the \$11.8 billion in Treasury securities, and by October 16, 1984, the entire amount was invested. Because the \$11.8 billion had not been invested on September 30, the fund lost interest. As discussed later in this chapter, the exact amount of the loss cannot be determined until the securities are redeemed or reach their maturity. However, the fund lost \$65.4 million through December 31, 1985, an amount which Treasury has restored in accordance with a specific provision in Public Law 99-272—the Consolidated Omnibus Budget Reconciliation Act of 1985.

Actions Relating to 1985

On September 30, 1985, OPM notified Treasury that it should invest about \$17.4 billion. As in 1984, the majority of these funds were associated with the special year-end fund deposits. Because of debt ceiling constraints, Treasury only invested about \$4 billion. The remaining funds were gradually invested in Treasury and FFB securities, and by November 14, 1985, all funds were invested. In November 1985, Treasury redeemed fund securities earlier than normal to reduce the government's outstanding debt. This allowed Treasury to borrow from the public and obtain the operating cash Treasury officials determined to be needed to pay fund benefits.

In late October 1985, Treasury's available cash for government operations was continuing to decrease. Because of the debt ceiling crisis, Treasury anticipated sufficient cash would not be available on November 1 to meet the government's obligations. Treasury officials stated that in order to borrow sufficient cash from the public to meet the fund's benefit payments, they decided to redeem \$1.5 billion in fund securities. On November 4, Treasury redeemed an additional \$198 million in fund securities to cover the benefit payments. Table 2.1 shows an example of the advantage of using this procedure during a debt ceiling crisis.

Table 2.1: Procedure Used to Raise Cash

Date	Action	Effect on Treasury's cash	Effect on outstanding debt
11-1-85	Treasury redeems \$1.5 billion of trust fund securities for benefit payments which were issued on November 1, 1985.	None	Reduces debt by \$1.5 billion
11-1-85	Treasury issues \$1.5 billion of securities to public for cash.	Increases cash by \$1.5 billion	Increases outstanding debt by \$1.5 billion

As Table 2.1 shows, although the total amount of the outstanding debt remained unchanged, Treasury was able to obtain \$1.5 billion in cash. This cash was then available to pay fund benefits. Had normal procedures been followed, Treasury would have redeemed only \$1.4 billion on November 1 since this was the amount of the benefit payments made by direct deposit. Treasury stated that the additional \$100 million was needed to ensure that Treasury had enough cash to cover checks actually presented on November 1, as well as electronic funds transfers. The remainder would normally have been redeemed on November 7 and 8 as requested by OPM. (See redemption policies in chapter 1.) Public Law 99-155, which was enacted to temporarily increase the debt ceiling until December 6, authorized Treasury to partially compensate the fund for the losses caused by Treasury's actions.

In early December 1985, Treasury again encountered debt ceiling constraints and did not follow its normal procedures. Instead, Treasury redeemed securities that would not otherwise have been redeemed and did not immediately invest some of the daily fund receipts. As it did earlier, the Congress enacted legislation to increase the debt ceiling as well as to compensate the fund for the losses resulting from Treasury's actions (Public Law 99-177). In accordance with both laws, Treasury has reimbursed the fund about \$95 million. This is in addition to the \$65.4 million reimbursed under the authority of Public Law 99-272. (See page 13.)

Other Unusual Actions Taken During Debt Ceiling Crisis

In 1985, Treasury for the first time invested Civil Service funds in FFB securities by redeeming Treasury securities and then purchasing similar FFB securities. Because FFB securities are not subject to the statutory debt ceiling, this action allowed Treasury to borrow more cash from the public. The interest rates and maturities were the same so the fund would not lose interest because of the transfer. At the time the transfer was made, Treasury computed the interest earnings on the Treasury securities redeemed. Treasury allowed OPM to use this interest to cover fund payments. However, the accrued interest on the redeemed Treasury securities exceeded the amount of cash needed for payments and this excess was not immediately invested as required by statute. We estimate that the fund lost about \$2.1 million because Treasury did not immediately invest the interest associated with FFB transactions.

Treasury officials initially explained to us that to have immediately invested the excess interest at that time would have been contrary to Treasury's policy of paying interest to the fund semiannually (that is,

December 31 and June 30). Crediting the fund with interest when the FFB transactions were made would have been contrary to Treasury's policy since interest would have been credited to the fund on days other than the semiannual payment dates. Therefore, the fund would have been allowed to compound its interest more frequently than semiannually. However, Treasury is specifically required by statute to immediately invest funds not needed to pay fund expenses. Upon further discussion with us, the officials agreed and the fund was reimbursed for this loss.

Further Losses Will Occur

As mentioned earlier, special legislation was enacted with the intent of fully restoring the fund's losses resulting from Treasury's actions during the debt ceiling crises. However, further losses related to those actions will occur in the future. The primary reason for this appears to be the difficulty in developing the precise language that would consider each case's complexity and projecting the long-term effect of Treasury's actions. To ensure that the fund suffered no losses, it would have been necessary to retroactively adjust the records to reflect how the investment portfolio would have looked had normal procedures been followed. However, two of the three laws authorizing restoration only allowed Treasury to compute the interest loss through specific dates. The interest rates on the securities purchased with the funds that were not immediately invested were substantially lower than the rates that were available when the funds should have been invested had the normal procedures been followed. Therefore, the fund's earnings will be less than they otherwise would have been. Although the exact amount of the future loss is difficult to estimate, it could be as much as \$13.6 million, depending on future interest rates. Treasury officials have agreed with our analysis and our estimates of the corresponding losses.

Additional Losses From 1984

The law requiring restoration of fund losses from the 1984 debt ceiling crisis was enacted in April 1986. It specified that Treasury should compute the interest loss through December 31, 1985. Although Treasury complied, the fund's long-term earnings will still be adversely affected because of the lower-rate securities available at the time of the restoration.

On June 30 of each year, Treasury converts the fund surplus into long-term securities bearing June's rate and with maturities of 1 to 15 years. Had Treasury not delayed investments in September 1984, at least some of the lost interest would have been invested in June 1985 in long-term

securities. These securities would have carried June's rate of 10.375 percent. Because of declining interest rates and the timing of the restoration, the restored interest earnings could only be invested in long-term securities bearing the June 1986 rate of 8.375 percent. Table 2.2 shows the potential loss assuming fairly constant interest rates. The exact amount of the loss cannot be determined until the securities are redeemed or reach their maturity date.

Table 2.2: Future Fund Losses

Dollars in millions			
Period	Interest assuming normal investment	Expected interest because of adjustment	Potential loss
9-30-1984 through 6-30-1986	\$68.8	\$68.6	\$0.2
7-1-1986 through 6-30-2000	68.5	55.3	13.2
Total	\$137.3	\$123.9	\$13.4

We broke this loss down into two periods. The first period ending June 30, 1986, was selected because Treasury restored the interest loss as of December 31, 1985, and because June 30, 1986, was the first time the loss could be invested into long-term securities. In addition, Treasury's interest loss computation included interest earned during this period. The last period was selected because, had the normal procedures been followed, all the securities would have reached their maturity date by June 30, 2000. However, if Treasury had been able to issue securities bearing a 10.375-percent rate and been able to compute the loss through June 30, 1986, then no future losses would have occurred.

Additional Losses From 1985

As mentioned previously, two separate pieces of legislation were enacted to mitigate the fund's losses resulting from Treasury's actions in 1985. Because neither law authorized Treasury to take the necessary actions to fully restore the loss, additional losses will occur. We estimate that these losses will total about \$220,000 in addition to the \$13.4 million because Treasury could not restore the loss as if normal procedures had been followed.

In December 1985, Treasury departed from its normal procedures by redeeming higher interest bearing Treasury securities when lower interest-bearing securities were available.⁶ Public Law 99-177 only

⁶See chapter 3 for a discussion of normal redemption procedures.

allowed Treasury to restore the interest loss associated with this transaction through December 12, 1985. However, it did not allow Treasury to either (1) compute the interest loss through June 30, 1986, the normal maturity date, or (2) restore the higher rate securities which were improperly redeemed. Therefore, interest losses from December 12, 1985, through June 30, 1986, cannot be restored to the fund without further legislation.

Conclusions

The unusual actions Treasury took to manage the government's finances during the 1984 and 1985 debt ceiling crises resulted in the fund losing interest earnings. We do not believe, however, that this was the intent of those actions. Although special legislation was required to restore the losses, the legislation, enacted with the intent of fully restoring the losses, fell short of this goal. Because the legislation was developed before the losses were fully determined, it was difficult for the Congress to anticipate the proper adjustments that would have been necessary to cover the long-term effect of Treasury's actions. Had the loss been first determined and then legislation written to compensate for it, the trust fund should not have incurred additional losses. However, the necessary information is now available to determine what is needed to fully compensate the fund.

Recommendations

We recommend that the Secretary of the Treasury direct the Financial Management Service to

- determine the amount of unrestored losses resulting from the 1984 and 1985 debt ceiling crises and
- seek the necessary legislative authority to fully restore those losses to the fund.

Agency Comments and Our Evaluation

Treasury agreed with our recommendations and stated that it will seek the necessary legislation and restore any losses to the fund. In a subsequent discussion, Treasury clarified its position and said that, although it has not yet identified the specific organization within Treasury that should be responsible for drafting the legislation, the legislation will be developed. OPM did not address these issues but rather deferred to Treasury, which is the fund manager, and stated that the fund should receive compensation for the unrestored losses. Treasury's and OPM's comments can be found in appendixes I and II, respectively.

Legal Restrictions and Internal Control Weaknesses Impact Fund Earnings

In addition to the losses that occurred because of Treasury's actions during the 1984 and 1985 debt ceiling crises, at least \$400,000 in other losses have occurred because of internal control weaknesses in the fund's operation. As agreed with the Chairman's office, we did not conduct a comprehensive review of the fund's investment practices. However, in the course of our work, we reviewed certain investment practices and found that internal control improvements were needed to ensure that

- securities are properly redeemed and
- error corrections and adjustments are accurate and properly documented.

Also, an important system that Treasury's Financial Management Service (FMS) uses to account for the investments of the various trust funds has not been evaluated for conformance with the Comptroller General's accounting principles, standards, and related requirements as stipulated by Treasury's procedures to implement the Federal Managers' Financial Integrity Act.⁷ Treasury's Inspector General (IG) also reported this problem in a 1986 audit report.

The fund also incurred losses as a result of OPM errors and Treasury's interest computation procedures. However, Treasury does not have the legislative authority to make full restitution for all the losses as well as the interest thereon.

Redemption Policies and Procedures

The fund has lost interest because Treasury did not always follow its normal redemption policy. When redemptions are necessary in order to pay for fund expenses, Treasury's stated policy is to redeem the securities with the shortest maturity first. Should a group of securities have the same maturity but have differing interest rates, then the securities with the lowest interest rate would be redeemed first.⁸ In addition, Treasury officials have stated that the policies followed should be equitable to the trust funds and the general fund.

⁷The Federal Managers' Financial Integrity Act requires federal agency heads to annually report on the status of their internal controls and the conformance of their accounting systems with the Comptroller General's accounting principles, standards, and related requirements. The act is viewed as an integral part of strengthening the government's financial management.

⁸In this report we refer to this policy as "redeeming the lowest interest rate securities first."

On November 6, 1985, Treasury redeemed \$105 million worth of Treasury securities with an interest rate of 10.75 percent when the fund's portfolio contained FFB securities with the same maturity date but bearing a lower interest rate of 10.125 percent. Similar transactions occurred on November 8 and December 2, 1985. Treasury officials stated that these redemptions were an apparent oversight and that procedures would be implemented to ensure that FFB securities, as well as the regular Treasury securities, are examined when determining which securities should be redeemed first. Treasury officials have restored that part of the loss allowed by Public Laws 99-155 and 99-177. (This loss is part of the \$160 million loss discussed in chapter 2.)

Improved Controls Needed Over Error Corrections

Treasury makes many adjustments to the accounting records in order to properly reflect accounting events. Reasons for adjustments include (1) information received late from OPM and (2) errors made by either Treasury or OPM. We found that Treasury does not have adequate procedures to ensure that its adjustments to the accounting records are properly documented and that the results of its adjustments are equitable. Therefore, Treasury cannot be reasonably sure that it has met its fund management responsibilities or its stated objective of ensuring equity between the trust funds and the general fund.

Error Corrections May Not Be Equitable

As a result of the procedure Treasury uses for correcting errors in fund transactions, the fund's earnings may be overstated or understated. This is contrary to Treasury's policy of maintaining an equitable relationship between the trust fund and the general fund, and it can distort the fund's earnings. Treasury officials stated that limitations in the investment accounting system precluded more accurate procedures.

Procedures for Making Adjustments—Current Month

Adjustments to current-month transactions are frequently made. In making these adjustments, an investment technician enters the current date and the date the transaction actually occurred and should have been entered. This practice is commonly referred to as an "as of" adjustment. This procedure allows interest to be computed as if the transaction had been recorded on the proper date. Although this procedure may appear to allow for an equitable adjustment, it may not because of the way Treasury decides which security will be adjusted.

The basic principle in selecting securities for adjustment is the same one that applies to making normal redemptions and investments (that is,

redeeming the lowest interest rate securities or investing in securities bearing the current month's rate). For example, assume that on July 1, 1985, Treasury redeemed \$10 million worth of 7-percent securities but on July 9, 1985, discovered that it should have redeemed only \$9 million worth of securities. To compensate for this difference, Treasury would have to invest \$1 million in securities. But by law, Treasury would have to invest in securities bearing the current month's rate, which may be more or less than 7 percent "as of" July 1, 1985. Conversely, if Treasury should have redeemed \$11 million in securities, then its procedures would require it to select the lowest rate security available for redemption on the adjustment date. In this example, the security may be one bearing a rate of 8 percent. It would then be considered redeemed "as of" July 1. (See example below.) In either case, the fund could gain, lose, or break even depending on interest-rate fluctuations.

Adjustments That Overlap Months

Some adjustments overlap months and pose similar problems in ensuring the fund's earnings are equitable. If an investment should have been made during the preceding month and was not recorded because of an error by the investing agency, then Treasury records the investment "as of" the first of the current month. This investment is made in a security bearing the current month's interest rate, which may be higher or lower than the rate in effect when the investment should have been made. Because the adjustment was caused by the agency, no attempt is made to compensate the fund for the previous month's interest that would have been earned.

More complex adjustments can occur. For example, if Treasury made the error, then an attempt is made to compensate the fund for the interest loss. This is done in a three-step process. First, the investment is shown "as of" the first of the current month. Next, Treasury computes the lost interest from the date the investment should have been made through the end of the previous month. Finally, Treasury accelerates the recording of investment of current month receipts until this interest is recovered. To illustrate how this works, if Treasury failed to invest \$1 million on March 21, but did not detect the error until April 15, then it would take the following actions:

- (1) Adjust the ledgers to show an investment of \$1 million on April 15, "as of" April 1.
- (2) Compute the interest that was lost from March 21 through March 31.

(3) Assuming the fund's receipts on April 2 totaled \$10 million and the interest rates for the March and April investments were the same, Treasury would adjust the ledger to show that the \$10 million was received on April 2, "as of" April 1. This would compensate the fund for the interest lost in March because investing the \$10 million 1 day earlier provides the fund the same amount of interest that it lost by not having the \$1 million invested for 10 days (March 21 through March 31), as shown below:

$$\$10 \text{ million} \times 12 \text{ percent} \times (1 \text{ day}/365 \text{ days}) = \$3,288$$

$$\$1 \text{ million} \times 12 \text{ percent} \times (10 \text{ days}/365 \text{ days}) = \$3,288.$$

As with current-month adjustments, although this method compensates the fund for the interest lost prior to the actual investment, it may result in excess interest being paid or an interest shortage if the interest rates between the months are not the same. This is because Treasury is required by law to invest in securities bearing the current month's rate, which may be higher or lower than the prior month's rate.

Fund Has Sustained Losses Because of Adjustment Practices

One error that Treasury made and corrected using the above procedures has cost the fund almost \$400,000. Specifically, according to Treasury records, OPM instructed Treasury to redeem about \$400 million of securities on July 5, 1984. However, Treasury did not and OPM notified Treasury of the error in August. Treasury then redeemed the lowest interest-bearing securities available at that time which had rates of 8.75 and 9.75 percent. The interest on these was computed through July 5 (the original requested redemption date). Lower-rate securities, which had been held by the fund on July 5, were no longer available since they had been used to pay fund expenses in July and early August, causing the trust fund to lose about \$400,000. Had the redemption taken place on July 5, the securities bearing interest rates of 7.5 and 7.625 percent would have been used. Therefore, the higher rate securities would have remained outstanding longer and more interest would have been earned. Treasury agreed with our methodology for computing the effects of this error and with the amount of the loss.

Accounting System Makes Corrections Difficult

To ensure that errors and other adjustments are completely and accurately corrected, it would be necessary to make retroactive adjustments in the records back to the time the errors occurred. In this manner, the fund's earnings would be the same as if no adjustment or error had been

made. Although Treasury officials agreed, they stated that this was impractical because of the large volume of transactions that must be processed daily through the system, which is manually operated, and because of the complexity of recomputing the fund's interest earnings.

After observing Treasury's operations, we agree that making all retroactive adjustments could cause a work load problem unless the system is properly automated. However, although Treasury officials said that plans had been made to automate the system, its implementation is not expected until 1988 or 1989. Furthermore, the system, as proposed, does not include a capability to make retroactive adjustments. As an alternative, Treasury could make retroactive adjustments on a selected basis. For example, errors involving small amounts could be corrected using the current procedures as discussed earlier in this chapter. Errors involving large amounts which could have a significant impact on the fund's earnings could be handled through retroactive adjustments.

**Reasons for Adjustments
Not Documented**

Because different situations call for different adjustment procedures, all adjustments must be completely documented, including a brief explanation of why they are made. Complete documentation is essential for establishing an audit trail to verify that the adjustments are proper. Such information is also needed to assure that adjustments are equitable and correct.

We found that during the 2 years ending June 30, 1986, Treasury's accounting records generally did not contain explanations for the adjustments that were made. As a result, we could not (1) verify that adjustments were in accordance with Treasury's policy and (2) determine their effect on the fund's earnings. Treasury officials stated that steps would be taken to ensure their personnel properly document the adjustments.

**Accounting System's
Conformance Has Not
Been Assessed**

An important system that Treasury's Financial Management Service (FMS) uses to account for the investments of the Civil Service fund and the other trust funds has not been evaluated for conformance with the Comptroller General's accounting principles, standards, and related requirements as required by Treasury's procedures implementing the Federal Managers' Financial Integrity Act. Treasury's IG also reported this problem in a 1986 audit report.

Treasury officials stated that this system should not be considered an accounting system since it is only a "mirror image" of the Bureau of Public Debt's general ledger. However, we do not agree that the Bureau of Public Debt system is an exact duplicate of the FMS system because, as the IG report pointed out, the FMS system

- records individual transactions based on legal authorizations and source documentation;
- classifies transactions according to entity, fund, ledger, as well as account structure; and
- reports detail and summary transactions which are used as the basis for reports prepared by the Bureau of Public Debt and submitted to the Congress, Treasury, and the public.

In addition, FMS's system is the basis for the trust fund entries made in the Bureau of Public Debt's system. However, the Bureau's system must rely on FMS's information since it does not have a means to ensure that the daily data it receives from FMS are accurate and reliable. Therefore, Treasury needs to perform the work necessary to assure itself that this operation conforms with the Comptroller General's principles, standards, and related requirements and that any material weaknesses are reported and corrected. Performing an evaluation for that purpose would include determining whether controls are adequate to ensure complete and accurate processing of all transactions. Had Treasury conducted such an evaluation, we believe the problems we found relating to the daily operations could have been detected and corrective actions initiated.

According to Treasury officials, this operation will be incorporated in the new Public Debt accounting system. This system is scheduled to be implemented in 1989.

Treasury's Interest Computation Method Was Changed to Ensure Accurate Earnings

We found that the interest computation method used by Treasury distorted the fund's semiannual interest earnings. We brought this matter to Treasury's attention, and the method was revised. Treasury's method for computing interest payments on most fund investments is based on a long-standing policy. This policy was developed in the early 1920's and is designed to ensure that equal semiannual interest payments will be made for securities held exactly 1 year. This method is comparable to the normal procedure for computing interest, which is to multiply the principal, interest rate, and amount of calendar time the funds are invested. Because annual interest rates are used, the calendar time is

typically expressed as some fractional amount of a year. Although the total annual interest is the same under both Treasury's method and the normal method, the semiannual amounts differ, as shown in table 3.1.

Table 3.1: Comparison of Interest Computation Methods

	Principal	Percentage rate			Time	Interest
Treasury method						
First semiannual period, July 1 - December 31	\$1 million	x	12	x	1/2 year	= \$ 60,000
Second semiannual period, January 1 - June 30	\$1 million	x	12	x	1/2 year	= 60,000
Total						\$120,000
Normal method						
First semiannual period, July 1 - December 31	\$1 million	x	12	x	(184/365)	= \$ 60,493
Second semiannual period, January 1 - June 30	\$1 million	x	12	x	(181/365)	= 59,507
Total						\$120,000

Because the Civil Service fund's current investments are held less than 1 year, Treasury's method does not ensure that the fund is neither overcompensated nor undercompensated for its investments. However, we did not attempt to assess the amount the fund may have gained or lost because of Treasury's interest computation method because we would have had to completely reconstruct Treasury's records for an entire investment year.

In June 1986, we requested Treasury's views on this matter. The Department responded that effective with the investment year beginning July 1, 1986, the interest computations for the Civil Service fund would be made based on a 365-day year. Treasury also stated that it would consider whether this change should also apply to other trust funds investing in par value specials and would defer any change for other trust funds until July 1, 1987, which is the beginning of the next investment year.

Authority for Restoring Losses Is Limited

As discussed above, not all losses are caused by Treasury actions, and Treasury does not have the authority to fully restore the losses that the fund has incurred. In our management letter to OPM, dated April 23, 1986, regarding the fiscal year 1984 financial audit, we outlined several areas that needed correction. One area was that OPM had not correctly calculated the year-end payments discussed in chapter 2 and thereby

underreported the amount to be invested. Specifically, OPM's errors caused the fund to be undercompensated by \$145 million, excluding interest, for fiscal years 1981, 1982, 1984, and 1985. We also pointed out that, although records were not readily available to determine additional amounts that may have been lost, the losses may go back as far as 1972. In our letter, we pointed out that OPM should determine the amount of these losses and seek restitution of these funds from Treasury. OPM stated that the principal has been restored as of September 30, 1986.

Although the fund can sustain losses in its routine operations, Treasury's ability to fully compensate the fund is limited. For example, although it can restore the principal amount that resulted from OPM's error, it cannot restore the lost interest earnings thereon. To do so would be contrary to the legal requirements that the United States not make interest payments unless specifically authorized by statute or contract.

Another legal requirement that restricts Treasury's ability to restore fund losses is that Treasury may only issue securities in a given month bearing that month's interest rate. Therefore, when Treasury fails to invest the proper amount in a given month, or prematurely redeems securities, it can only reinvest in securities bearing the current month's rate. We believe that Treasury should seek additional broad authority to allow it to correct previous mistakes so that the fund receives proper interest earnings.

Treasury officials stated that they do not favor such unlimited and unconditional authority for three reasons. First, it would give the impression that Treasury does not have the legal basis to make the type of adjustments it currently makes. Second, the authority could be viewed as a requirement to make numerous adjustments that are caused by minor agency errors. Treasury stated the correction of such errors is not only administratively difficult but also leaves a substantial risk of creating further errors. Third, this type of authority could be viewed as a means to circumvent the debt ceiling. However, the legality of Treasury's current adjustment practices has not been questioned, and we believe the procedures used are within Treasury's current authority. We also believe that legislation properly worded to indicate that its purpose is to treat the fund in an equitable manner could help overcome perceptions that Treasury must compensate funds for all minor errors caused by the agencies.

During September and October 1986, Treasury also did not invest trust fund receipts because of debt ceiling constraints. In October 1986, a law^a was passed which authorized Treasury to take the necessary steps to restore Civil Service fund losses arising from both current and future debt ceiling problems without further congressional approval. The law addresses our concerns relating to losses incurred during future debt ceiling crises and should eliminate the perception that the authority we believe Treasury should seek could be viewed as a means of circumventing the debt ceiling. However, the October 1986 law does not provide Treasury with the authority to restore the types of losses discussed in this chapter which are caused by its routine operations nor the losses discussed in chapter 2.

Conclusions

Treasury's system for accounting for fund investments needs to be improved to better control securities transactions. The system should also be evaluated as part of the Department's ongoing Federal Managers' Financial Integrity Act program to ensure that additional weaknesses do not develop and that existing weaknesses are corrected. The fund has sustained losses because of system weaknesses, and it is essential that procedures be improved to minimize any future losses. Although correcting all errors through retroactive adjustments may be beyond Treasury's current system capabilities, at least the major adjustments should be handled in that manner to better ensure the accuracy of the fund's earnings. This is particularly important since the planned system also does not have the capability to adequately account for such adjustments.

During the periods covered by our review, Treasury generally appeared to follow its policy of ensuring equity between the trust fund and the general fund—a policy we support. Treasury's prompt revision of its interest computation method and its efforts to determine whether the change should be instituted for other trust funds is an illustration of Treasury's good faith in attempting to treat all funds equitably. However, legal restrictions have limited Treasury's ability to fully reimburse the fund for losses resulting from errors and other problems that occur in its routine operation. Because of its role as fund manager, we believe it is Treasury's responsibility to seek whatever legislation is necessary to allow it to fully reimburse the fund.

^aPublic Law 99-509, Omnibus Budget Reconciliation Act of 1986.

Recommendations

We recommend that the Secretary of the Treasury direct the Financial Management Service to

- document properly all adjustments to the accounting records,
- establish controls to ensure that the lowest interest rate securities are redeemed first, and
- evaluate the fund's accounting operations for conformance with applicable accounting principles and standards.

We further recommend that the Secretary seek legislative authority to fully reimburse the fund for losses resulting from future Treasury or OPM management of fund transactions. Since developing legislation for each individual loss that may occur is difficult and may not result in full compensation, this legislation should not be designed to cover a specific case(s) but instead should establish criteria which would (1) allow Treasury to pay interest when securities have not been issued and (2) generally define when this authority could not be used. This legislation should also modify the current restriction of only issuing par value securities at the current month's rate. For example, when an adjustment becomes necessary, the Secretary should be allowed to issue securities at the same rate that was in effect when the transaction should have been recorded. The guiding principle in this legislation should be that the trust funds and the general fund are treated in an equitable manner. After such authority is received, FMS should be directed to treat major error corrections as retroactive adjustments and thereby fully eliminate the effect of the error.

Agency Comments and Our Evaluation

Treasury agreed with our recommendations that it seek broad legislative authority over investment accounting and that it properly document adjustments. It stated that action has already been taken to accomplish proper documentation.

The Department did not agree that improved controls were needed and provided examples of procedures used which it considers adequate. Treasury also stated that the controls of this system had recently been reviewed as part of the latest agency Federal Managers' Financial Integrity Act section 2 review.

We do not agree with the Department's position that it has adequate internal controls for the following reasons:

- The 1984 Financial Integrity Act review cited by Treasury does not appear to accurately reflect current operations because (1) the Treasury Inspector General reviewed the assessment and found that the working papers documenting the review did not adequately support the report and (2) our review of the report disclosed inconsistencies with the current operations. For example, the report stated that standard operating procedures were comprehensive and clearly written but in need of some updating. Our review disclosed that they are no longer current and the procedures being followed are not completely documented. Also, a 1986 Inspector General audit report noted the need for improvements in internal controls and adherence to generally accepted government accounting principles.
- If adequate controls had been in place to ensure that the lowest interest rate securities are redeemed first, then the situation discussed on page 21 would not have occurred. Treasury would have redeemed the about \$400 million as requested in July, and the fund would not have lost about \$400,000.

In responding to this report, Treasury officials stated that they still do not consider this operation an accounting system. However, in subsequent discussions, Treasury stated that when the new Public Debt accounting system is evaluated for conformance with the Comptroller General's principles and standards, any needed evaluation of the Financial Management Service's operations would be included. We believe our concerns will be adequately addressed if the Financial Management Service's operations are reviewed as part of the Public Debt accounting system evaluation.

Treasury's specific comments are provided in appendix I.

Comments From the Department of the Treasury

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON

February 20, 1987

Dear Mr. Wolf:

This letter responds to your request of December 22, 1986, for our review and comments on the General Accounting Office's (GAO) Draft Report, "Civil Service Fund: Improved Controls Needed Over Investments." We welcome the opportunity to comment on your report. The recommendations contained therein have been carefully studied by the Department's Financial Management Service (FMS). Where appropriate, measures will be taken to comply with those recommendations.

A detailed analysis of each of the recommendations is presented below. In addition, there are several technical corrections that we suggest be made to the report. These corrections will follow the above analysis.

RECOMMENDATIONS

Proper Documentation of Adjustments

We agree with GAO's recommendation to properly document adjustments to the accounting records, and FMS has already taken steps to accomplish it.

Change the Accounting Review Mechanism

We do not agree with the GAO's contention that FMS's Finance and Funding Branch's investment operation is an accounting system subject to section 4 of the Financial Managers' Financial Integrity Act (FMFIA).

The question of the Finance and Funding Branch's investment operation being classified as an accounting system subject to section 4 has been addressed by FMS several times in the past. FMS believes that section 2 FMFIA reviews provide for a more comprehensive review of the system of internal controls relating to the investment operation. In support of their position, FMS has conducted a test of the investment operations' suitability as an accounting system utilizing the Departmental questionnaire for conducting section 4 reviews. It was determined that 99 percent of the responses to the questions in the survey were not applicable. Treating the investment operations as an assessable unit under section 2 enables FMS to better comply with the intent of FMFIA.

The accounting system for each of the accounts in the Government Accounts Series (GAS) investments, which includes the Civil Service Retirement and Disability Fund, is maintained by the

See comment 1.

See comment 2.

- 2 -

individual program agencies and the Bureau of the Public Debt (BPD). Both of these organizations conduct section 4 FMFIA reviews. FMS's investment operation simply reports the results of transactions to the program agencies and BPD so that they may update their systems and the governmentwide Central Accounting and Reporting System.

Finally, the GAO draft report focused only on Treasury's management of the Civil Service Retirement and Disability Fund. In light of the fact that GAO is currently conducting a comprehensive review of all trust fund investment procedures, we believe that this recommendation is premature and should be deferred until the review is completed.

Improved Internal Controls

We also disagree with GAO's third major recommendation, that improved internal controls are needed over FMS's investment operations.

Procedures are currently in place that are designed to identify any irregularities or discrepancies between Treasury, OPM, and BPD. All investment and redemption requests from OPM are confirmed in writing by OPM in the same month the transaction takes place. All interest calculations are verified by BPD. All transactions are double-checked by the Finance and Funding Branch. Finally, all investment ledgers are independently verified on a weekly basis to insure accuracy, and all investment fund balances are verified on a monthly basis to the Monthly Statement of the Public Debt. These procedures provide comprehensive control mechanisms over all transactions processed. Any discrepancies that are identified are normally adjusted so that there is no negative impact on fund earnings.

Our position is supported by the findings of the independent firm, McManus & Associates, which conducted the latest section 2 FMFIA review at FMS. In their report they identified no material weaknesses in the Finance and Funding Branch's system of internal controls. On the contrary, they asserted that the investment operation was operating with a high degree of accuracy in a generally effective manner with appropriate attention to internal control principles.

Technical Corrections

There were five places in the draft report where we felt clarifying or explanatory language was needed. They are indicated below, with any deleted language in brackets and any added language underlined:

- o Page 23 (First Full Sentence)

"This allowed Treasury to borrow from the public and obtain the operating cash Treasury officials [maintain was] determined to be needed to pay fund benefits."

See comment 3.

Now on p. 13.

See comment 4.

Appendix I
Comments From the Department of
the Treasury

- 3 -

Now on p. 14.
See comment 5.

- o Page 24 (First Paragraph, Third Sentence)

Insert a new sentence after the third sentence: "The additional \$100 million was needed to ensure that Treasury had enough cash to cover checks actually presented on November 1, as well as electronic funds transfers."

Now on p. 25.
See comment 6.

- o Page 45 (Last Paragraph, First Sentence)

"Treasury officials stated that they do not favor [such] unlimited and unconditional authority for three reasons."

Now on p. 25.
See comment 7.

- o Page 46 (First Full Sentence)

After "agency errors" the following should be added: "The correction of which is not only administratively difficult but also leaves a substantial risk of creating further errors."

See comment 8.

- o Page 46 (Last Paragraph, Third Sentence)

"It appears that the law addresses our concerns"

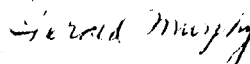
See comment 9.

CONCLUSION

In sum, the Department agrees with the GAO recommendation regarding proper documentation of accounting adjustments, but does not agree with the characterization of the Finance and Funding Branch's investment operation as an accounting system subject to section 4 FMFIA review or with the need to strengthen the Branch's system of internal controls.

Finally, the Department will support the introduction of legislation to fully reimburse the Civil Service Retirement and Disability Fund and provide unlimited and unconditional restoration authority, if it is deemed necessary by GAO.

Sincerely yours,



Gerald Murphy
Fiscal Assistant Secretary

Mr. Frederick D. Wolf
Director, Accounting and
Financial Management Division
U.S. General Accounting Office
Washington, D.C. 20548

The following are GAO's comments on the Department of the Treasury's letter dated February 20, 1987.

GAO Comments

1. No change to report needed.
2. This operation is to be replaced in 1989 by a new Public Debt accounting system. We believe our concerns over determining conformance with applicable accounting principles and standards will be satisfied if the overall evaluation of the new Public Debt accounting system includes the FMS operations. The report has been changed to reflect this.
3. We do not agree with Treasury's position that improved internal controls are not needed. Although an independent review of the investment operations was performed in 1984, a Treasury IG review of the report found that the working papers documenting the work did not adequately support the report. Our review of this same report disclosed inconsistencies with current operations. Also, a 1986 Treasury IG audit report noted the need for improvements in internal controls. See agency comments section of chapter 3.
4. Report changed.
5. Report changed.
6. Report changed.
7. Report changed.
8. No change to report needed.
9. See agency comments section in chapters 2 and 3.

Comments From the Office of Personnel Management

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



United States
**Office of
Personnel Management**

Washington, D.C. 20415

In Reply Refer To

Your Reference

12

Rosslyn S. Kleeman
Senior Associate Director
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Ms. Kleeman:

We have reviewed your draft report entitled *Civil Service Fund: Improved Controls Needed Over Investments (AFMD-87-17)* and have the following comments.

The Office of Personnel Management (OPM) has been charged under law with administering the Civil Service Retirement System (CSRS). Thus, OPM is responsible for calculating obligations to the CSRS, for ensuring the prompt and accurate collection of monies due the CSRS, and for authorizing accurate and timely payments from the CSRS fund. However, by law, the Secretary of the Treasury has been charged with the responsibility for investing CSRS funds and for managing the portfolio of securities which comprise the CSRS fund. The report properly recognizes this alignment of responsibilities by directing recommendations resulting from your review to the Department of the Treasury for action. Even though the report does not contain any specific recommendations for OPM action, there are two areas we would like to address.

See comment 1.

First, we agree, in principle, with your recommendation that the CSRS fund should be "made whole" when available funds are not properly invested. We feel this is especially important for situations like the two periods of time when the CSRS fund lost interest as a result of debt ceiling limitations. However, we recognize that there may be some practical limitations to restoring interest in every situation where interest is lost (e.g., through administrative error and the amounts are not significant). Since OPM does not manage the investment process or make day-to-day investment decisions, we are deferring to the Department of the Treasury for the development of the proper framework to implement the principle we have set forth above.

See comment 2.

Second, the report mentions that, through an administrative error, OPM understated the amount of interest on the unfunded liability that should have been credited to the CSRS fund. We are pleased to report that OPM recalculated the amount due the CSRS fund and the principal was deposited on September 30, 1986.


CON 114-24.3
January 1990

**Appendix II
Comments From the Office of
Personnel Management**

2.

I thank you for the opportunity to comment on your draft report. If you have any questions, please give me a call or your staff may contact Mr. John D. Webster at 632-6077.

Sincerely,


James W. Morrison, Jr.
Associate Director
for Retirement and Insurance

**Appendix II
Comments From the Office of
Personnel Management**

The following are GAO's comments on the Office of Personnel Management's letter dated January 12, 1987.

GAO Comments

1. No change to report needed.
2. Report changed to reflect this. See p. 25.

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