United States General Accounting Office

GAO

Report to the Congress

September 1989

FINANCIAL AUDIT

Federal Financing Bank's Fiscal Year 1988 Financial Statements

139966

GAO

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

Comptroller General
of the United States

B-206380

September 29, 1989

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

This report presents our opinion on the Federal Financing Bank's financial statements for the year ended September 30, 1988, disclosing that the financial statements present fairly, in all material respects, the Bank's financial position and the results of its operation and cash flow. This report also presents our reports on the Bank's system of internal accounting controls and on its compliance with laws and regulations. We conducted our audit in accordance with generally accepted government auditing standards.

The Bank is an instrumentality of the United States within the Department of the Treasury. Under 12 U.S.C. 2293, the Bank is subject to the budget and audit provisions of the Government Corporation Control Act (31 U.S.C. 9105) applicable to wholly owned government corporations named in 31 U.S.C. 9101(3).

The Bank incurred a net loss of $1.15 billion during fiscal year 1988, due entirely to a $1.29 billion prepayment premium owed to the Department of the Treasury. The Bank was legislatively prohibited from collecting any related prepayment premium from borrowers who prepaid their debt. The legislation precluded the Bank from enforcing provisions in the loan notes that require the loans to be prepaid at their then current market value. However, it did not provide the Bank with rights to prepay its Treasury borrowing in ways other than under the terms of the agreement existing between the Bank and Treasury which required that the debt be prepaid at the then current market value.

As of September 30, 1988, the Bank had $146.3 billion of loans receivable and $4.3 billion of accrued interest receivable. Most of these loans are guaranteed by federal agencies. When an agency must honor its guarantee because a borrower defaults, that agency must obtain an appropriation or use other resources to pay the Bank. However, if these resources are not available to the agency to repay the Bank, and the Bank is legislatively required to absorb the agency's debt, the Bank would incur a loss as a result of these loans.

Our report on the Bank's internal accounting controls discloses that the Bank's system of internal accounting controls, while significantly improved since our last audit, still had material weaknesses. Our report provides details on our findings and our recommendations for improvement.

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

Brian P. Crowley for

Charles A. Bowsher
Comptroller General
of the United States

Contents

Abbreviations

EXIM	Export-Import Bank
CSRDF	Civil Service Retirement and Disability Fund
REA	Rural Electrification Administration
SBA	Small Business Administration

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To the Board of Directors
Federal Financing Bank

We have audited the accompanying statement of financial position of the Federal Financing Bank as of September 30, 1988, and the related statement of income and retained earnings and statement of cash flow for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Bank as of September 30, 1987, were audited by the Office of the Inspector General, Department of the Treasury, whose report dated May 20, 1988, expressed an unqualified opinion on those statements. In addition to this report on our audit of the Bank's fiscal year 1988 financial statements, we are also reporting on our consideration of its system of internal accounting controls and compliance with laws and regulations.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Federal Financing Bank as of September 30, 1988, and the results of its operation and its cash flow for the year then ended, in conformity with generally accepted accounting principles.

As described in note 1 to the financial statements, the Bank was established to assist and coordinate government agency borrowing and guaranteed borrowing by government agencies to reduce the cost to the federal government of some of its borrowing operations. In general, loans made by the Bank are fully guaranteed by the federal government and are collectible. However, loans, or certain provisions of loans, could result in losses to the Bank if legislative actions are taken to modify the original terms of the loans.

The following supplementary information discusses a loss the Bank incurred in 1988 and agencies that have borrowed from the Bank that have a significant number of problem loans.

Bank Incurs Loss on Debt Prepayment

The Bank incurred a net loss of $1.15 billion during fiscal year 1988. Section 1401 of the Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203), sections 101(e) of Title III and 101(k) of Title VI of the Continuing Appropriations Act for fiscal year 1988 (Public Law 100-202), and section 1011 of the Omnibus Budget Reconciliation Act of 1986 (7 U.S.C. 936(a)) required the Bank to accept certain loan prepayments from borrowers at par (book) value. Based on the original loan terms, the Bank would have collected $1.29 billion in premiums due as a result of these loan prepayments. However, this legislation prohibited the Bank from assessing the premiums by allowing the borrowers to repay at book value. Although not contractually required to prepay its related Treasury debt, the Bank repaid the debt to Treasury at market value, in accordance with its debt agreement. Prepaying the debt owed to Treasury when borrowers prepay their loans conforms with the Bank's normal operating procedures. The difference in the market value of the debt prepaid to Treasury and the book value of the debt resulted in a $1.29 billion loss to the Bank during 1988.

The Bank's Loans and Interest Receivable

The Bank has reported $146.3 billion of loans receivable and $4.3 billion of accrued interest receivable as of September 30, 1988. Recent financial statement audits of three of the primary agencies with outstanding loans from the Bank show that they have significant numbers of problem loans, as discussed below.

- The Farmers Home Administration, which had $58.5 billion in loans from the Bank, or 40 percent of the Bank's total loans receivable, reported an accumulated deficit of $36 billion as of September 30, 1987. Its audited 1987 financial statements reflect loss allowances of $19.0 billion, or 40 percent of its loans and interest receivable. (See Financial Audit: Farmers Home Administration's Losses Have Increased Significantly, GAO/AFMD-89-20, dated December 20, 1988.)
- The Rural Electrification Administration (REA), which had $23.3 billion in loans from the Bank, or 16 percent of the Bank's total loans receivable, incurred a net loss of $956 million during fiscal year 1987. This loss was due primarily to an $837 million increase in REA's allowance for loss on loans receivable and guaranteed loans. (See Financial Audit:

Rural Electrification Administration's Financial Statements for 1987, GAO/AFMD-89-21, dated December 23, 1988.)

- The Export-Import Bank (EXIM), which had $11.0 billion in loans from the Bank, or 8 percent of the Bank's total loans receivable, reported a cumulative deficit of $116.4 million at September 30, 1988. In addition, due to EXIM's policy of not providing loss reserves on foreign sovereign debt, it had an unrecorded loan loss allowance which, had it been recorded, would have resulted in an estimated cumulative deficit of between $3.7 billion and $6.2 billion. (See Financial Audit: Export-Import Bank's 1988 and 1987 Financial Statements, GAO/AFMD-89-94, dated July 25, 1989).

Almost all of the Bank's loans are to federal agencies or to private sector borrowers whose loans are guaranteed by a federal agency. When an agency has to honor its guarantee because a borrower defaults, that agency must obtain an appropriation or use other resources to pay the Bank. However, if an appropriation is not made or federal agencies are not allowed to fund losses by borrowing from the Treasury, and the Bank is legislatively required to absorb the debt the agency owes it, the Bank would incur the loss.

Brian P. Crowley for

Charles A. Bowsher
Comptroller General
of the United States

August 16, 1989

Report on Internal Accounting Controls

We have audited the financial statements of the Federal Financing Bank for the year ended September 30, 1988, and have issued our opinion thereon. As part of our audit, we made a study and evaluation of the system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Bank's financial statements.

For purposes of this report, we have classified the significant internal accounting controls into the following categories:

- borrowing,
- expenditures,
- financial reporting, and
- lending.

Our study included all of the control categories listed above, but we did not evaluate the internal accounting controls over all functions within the categories. Because we identified significant internal accounting control weaknesses, we limited our study and evaluation to a preliminary review of all of the control categories listed above and expanded our substantive audit tests. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting controls taken as a whole or on any of the categories of controls previously identified.

The Bank's management is responsible for establishing and maintaining a system of internal accounting controls in accordance with the Accounting and Auditing Act of 1950 and the Federal Managers' Financial Integrity Act of 1982. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system of internal accounting controls are to provide management with reasonable assurance that (1) obligations and costs are in compliance with applicable laws, (2) funds, property, and other assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenditures applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over assets. Because of inherent limitations in any system of internal accounting controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

The Bank evaluated its system of internal accounting and administrative controls in accordance with the Federal Managers' Financial Integrity Act of 1982 as a subsystem of the Investment Accounting Branch of the Financial Management Service, a bureau of the Department of Treasury. In its Financial Integrity Act report for fiscal year 1988, the Financial Management Service reported that its systems of internal accounting and administrative controls, taken as a whole, provided reasonable assurance that the required control requirements were being complied with. We reviewed the report and considered its statements in conducting our study and evaluation and determining the nature, timing, and extent of our audit tests. The report did not identify any material weaknesses at the Bank.

Our study and evaluation, made for the limited purpose described in the second paragraph, would not necessarily disclose all material weaknesses in the system of internal accounting controls. Accordingly, we do not express an opinion on the Bank's system of internal accounting controls taken as a whole or on any of the categories of controls identified in the second paragraph. Our study and evaluation disclosed that the Bank had corrected several internal accounting control weaknesses discussed in the report on our fiscal year 1985 study and evaluation of the Bank's internal accounting controls. (See Financial Audit: Federal Financing Bank's Financial Statements for Fiscal Years 1985 and 1984, GAO/AFMD-87-31, dated September 30, 1987.) However, we found that two internal accounting control weaknesses which we believe pose a high degree of risk that material errors and irregularities could occur and not be promptly detected still exist. The following sections discuss both those weaknesses the Bank has corrected as well as those that still exist.

The Bank Has Taken Action on Internal Accounting Control Weaknesses, but Some Still Remain

In the report on our fiscal year 1985 study and evaluation of the Bank's internal accounting controls, we disclosed that the Bank (1) did not have formal, up-to-date accounting policies and procedures manuals, (2) did not routinely or accurately maintain its general and subsidiary ledgers, (3) did not promptly reconcile its general ledger cash account with reports from Treasury, (4) incorrectly processed interest receivable, interest payable, and administrative expense accruals, and (5) often grouped transactions in batches and recorded only the net amounts. We also reported that Treasury reports of Bank borrowing and repayment activity were inaccurate. The Treasury Fiscal Assistant Secretary, who was also the Bank's Vice President and Treasurer, agreed with our findings and outlined a series of actions which were to be undertaken to correct the reported weaknesses.

During our fiscal year 1988 audit, we determined that the Bank has taken actions which have resulted in improvements in its internal accounting controls. Specifically, the Bank

- developed an accounting policy and procedures manual and distributed it to personnel;
- completed reconciliations of cash with Treasury in a timely manner;
- recorded transactions in gross rather than net amounts, thus reducing the frequency of errors in recording transactions; and
- due to its policy of recording transactions on a cash basis during the year, now reverses its interest accruals from the prior year to ensure that the current year income and expense amounts are properly stated.

These actions improved the Bank's internal accounting control system; however, the Bank is still not reviewing and reconciling Bank loan activity to external Treasury reports. This lack of review and reconciliation does not affect the Bank's financial statements because they are audited. However, without such a reconciliation, there is no assurance that Treasury's public reporting of the Bank's operations is accurate. We also found that the Bank is not routinely maintaining and updating its general and subsidiary ledgers and is not verifying interest accrual computations.

General and Subsidiary Ledgers Are Not Properly Maintained

Standard accounting practices include routinely updating and maintaining an entity's general and subsidiary ledgers to provide prompt, accurate financial data to managers for decision-making purposes. The Bank's accounting policy and procedures manual states that general ledger transactions should be recorded when they occur. However, during fiscal year 1988, the Bank did not update its general ledger in accordance with its policy and procedures manual. It also did not have subsidiary ledgers for some of its activities. As a result, we identified the following problems.

- Accounting personnel were recording cash transactions in the general ledger 30 to 60 days after the transaction had occurred, which increases the likelihood of errors being made due to the untimely recording of transactions. Approximately 17 percent of all entries the Bank recorded in the general ledger during fiscal year 1988 were entries made to correct errors made in previously recorded entries.

- The Bank cannot correctly compute accrued interest on loans it purchased from the Small Business Administration (SBA) or verify that the amounts received from SBA are correct. The Bank purchased these loans at a discount from their face value and receives interest payments from SBA at the contractual interest rate. Generally accepted accounting principles require the Bank to amortize the discount over the life of the loans as an adjustment to the yield on the loan, which, when added to the contract rate, results in the loans earning a higher effective rate of interest. Further, the principles require interest to be accrued at the contract rate as it is earned. The Bank correctly amortizes the discount on the loans. However, because the Bank does not have detailed subsidiary records of the individual purchased loans and their respective contractual interest rates, it accrues interest at the effective rate instead of the contractual rate. By amortizing the discount and accruing interest at the effective versus contractual interest rate, the Bank is double counting the effect of the discount. Although this double-counting resulted in fiscal year 1988 income being overstated by only $48,000, if the Bank purchases more loans at a discount, the lack of subsidiary records could materially affect its financial statements. Further, since the Bank relies on financial information SBA reports to it, the Bank cannot verify that the amounts received from SBA are correct.
- The Bank cannot correctly compute interest expense on its Treasury debt because it does not maintain subsidiary records of this debt. Until 1986, the terms and conditions of the Bank's debt always matched those of the corresponding loans it made. Consequently, even though it did not have subsidiary records, it could correctly compute interest payable to Treasury by using the interest rate on the loans on which it received payment. However, in 1986, the Bank borrowed $15 billion from the Civil Service Retirement and Disability Fund (CSRDF) on terms and conditions that differed from its usual loans. The Bank then remitted the loan from CSRDF to Treasury without identifying which loans from Treasury were being repaid. The Bank calculates total interest payable by using the original Treasury interest rate associated with loans on which payment is received as though the full amount of interest due is owed to Treasury. It then remits to Treasury the difference between the total interest payable calculated and the amount owed to CSRDF. Because it does not maintain subsidiary records of its debt to Treasury and has not identified which Treasury debt was repaid with the proceeds from the CSRDF borrowing, the Bank has no assurance that it calculates and remits the proper amount to Treasury.

Interest Accruals Are Not Verified

Because the Bank reports financial results annually, it computes and records interest accruals only at fiscal year-end. Controls should be in place to ensure that the proper amount is accrued. The Bank's policies require someone other than the preparer of the interest accrual computation to verify, on a test basis, whether interest rates, interest payment dates, principal balances, and interest calculations are correct. However, the Bank did not complete the required interest accrual verifications for fiscal year 1988 accruals.

The accounting manager stated that the required verifications were not completed for the fiscal year 1988 accruals because personnel were diverted to higher priority projects. We found that the Bank incorrectly computed 8 of the 31 interest accrual calculations recorded as of September 30, 1988. As a result, accrued interest receivable and interest income was understated by $21.6 million and accrued interest payable and interest expense was understated by $12.9 million.

Conclusions

Although the Bank has significantly improved its internal accounting controls since our internal accounting control report on our fiscal year 1985 audit, the remaining weaknesses still pose a high degree of risk that material errors in the Bank's financial records could occur and not be promptly detected. By not developing appropriate subsidiary ledgers, recording general ledger transactions promptly, or independently verifying the interest accrual computations, the Bank is not assured that its financial statements are accurate and reliable.

Recommendations

We recommend that the Secretary of the Treasury direct the Bank's President to

- record general ledger cash transactions as incurred and review and record interest accruals as required by the Bank's accounting policy and procedures manual;
- develop and maintain detailed subsidiary records of the SBA loans purchased, including information on the contractual interest rates, to facilitate the correct computation of accrued interest on these loans; and
- develop and maintain subsidiary records for the Bank's debt which correlate the outstanding amounts owed to Treasury and CSRDF to the related loans receivable to ensure that the Bank pays the proper amount of interest on its Treasury debt.

Agency Comments

We did not request official written comments on this draft. However, we provided a draft of this report to Bank officials and they concurred with our findings and recommendations. Further, they indicated their commitment to correct the problems noted.

Report on Compliance With Laws and Regulations

We have audited the financial statements of the Federal Financing Bank for the year ended September 30, 1988, and have issued our opinion thereon. We conducted our audit in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures, including tests of compliance with laws and regulations, as we considered necessary in the circumstances. This report pertains only to our review of compliance with laws and regulations for the year ended September 30, 1988.

The Bank's management is responsible for compliance with laws and regulations applicable to the Bank. In connection with our audit referred to above, we selected and tested transactions and records to determine the Bank's compliance with laws and regulations, noncompliance with which could have a material effect on the Bank's financial statements.

As part of our audit, we reviewed and tested compliance with provisions of the Federal Financing Bank Act of 1973 (12 U.S.C. 2281-2296; section 2 of the Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512 (b) and (c)); and related regulations. In our opinion, the Bank complied with the terms and provisions of laws and regulations for the transactions tested that could have materially affected its financial statements. In connection with our audit, nothing came to our attention that caused us to believe that the Bank was not in compliance with the terms and provisions of laws and regulations for those transactions not tested.

Financial Statements

Statements of Financial Position

	As of September 30, 1988	1987
	(in thousands)	
ASSETS		
Funds with U.S. Treasury	$ 880,668	$ 444,065
Loan receivable - net (Notes 2, 4, and 5)	146,329,826	157,547,345
Accrued interest receivable	4,321,694	4,740,237
Accounts receivable	4,864	2,714
Total assets	$151,537,052	$162,734,361
LIABILITIES AND ACCUMULATED DEFICIT		
Debt (Notes 3 and 4)	$146,546,133	$157,537,929
Accrued interest payable	4,756,772	5,129,458
Debt prepayment premium (Notes 4 and 5)	1,481,238	165,605
Other liabilities	1,052	991
Total liabilities	152,785,195	162,833,983
Commitments and contingencies (Note 5)		
Accumulated deficit	(1,248,143)	(99,622)
Total liabilities and accumulated deficit	$151,537,052	$162,734,361

See accompanying notes.

Statements of Income and Changes in Retained Earnings

	For the year ended September 30, 1988	1987
	(in thousands)	
Interest on loans	$ 16,572,652	$ 17,226,907
Interest on borrowings	16,403,744	17,031,457
Net interest income	168,908	195,450
Administrative expenses	1,796	1,566
Net income before extraordinary item	167,112	193,884
Extraordinary item: Debt prepayment premium (Note 4)	(1,315,633)	(165,605)
Net income (loss)	(1,148,521)	28,279
Retained earnings (accumulated deficit) - beginning of the year	(99,622)	73,049
Transfers to the U.S. Treasury	0	(200,950)
Accumulated deficit - end of the year	$ (1,248,143)	$ (99,622)

See accompanying notes.

Statements of Cash Flow

	For the year ended September 30, 1988	1987
CASH FLOWS FROM OPERATIONS		
Net income (loss)	$(1,148,521)	$ 28,279
Adjustments to reconcile net income (loss) to net cash provided:		
Increase in accounts receivable	(2,150)	(2,739)
Decrease (increase) in accrued interest receivable	418,543	(169,750)
Increase (decrease) in accrued interest payable	(372,686)	223,572
Increase in debt prepayment premium	1,315,633	165,605
Increase in other liabilities	61	409
Discount amortization	(796)	(1,622)
Net cash from operations	210,084	243,754
CASH FLOWS FROM INVESTING ACTIVITIES		
Loan disbursements	(30,110,387)	(40,917,505)
Principal collections	41,280,030	40,524,993
Net cash from investing activities	11,169,643	(392,512)
CASH FLOWS FROM FINANCING ACTIVITIES		
Advances	40,110,672	40,917,505
Repayment of advances	(51,053,796)	(40,558,852)
Net cash from financing activities	(10,943,124)	358,653
Net increase in cash	436,603	209,895
Cash - beginning of the year	444,065	234,170
Cash - end of the year	$ 880,668	$ 444,065

See accompanying notes.

Notes to the Financial Statements

1. Summary of Significant Accounting Policies

The Federal Financing Bank ("Bank") was created by the Federal Financing Bank Act of 1973 (12 U.S.C. 2281) as an instrumentality of the U.S. government. Although originally created as an off-budget entity, the Bank was subsequently placed on-budget by Public Law 99-171. The Bank was established to assist and coordinate agency borrowing and guaranteed borrowing to reduce the cost to the federal government of some of its borrowing operations. The Bank has authority to purchase agency debt and guaranteed obligations from a federal agency and to finance these transactions by borrowing from the Treasury or the public.

Certain items in the September 30, 1987 financial statements have been reclassified to conform to the September 30, 1988 financial statement presentation.

Basis of Accounting

The financial statements are prepared in accordance with generally accepted accounting principles, and therefore are presented on an accrual basis.

Interest Rates on Loans

In general, the Bank charges its borrowers an interest rate that is one-eighth of one percent more than the rate on the Treasury debt incurred to fund the related loan receivable. The income resulting from the one-eighth of one percent is used to cover the Bank's administrative expenses.

Allowances for Loan Losses

The Bank does not establish an allowance for loan losses because loan principal and interest are guaranteed by federal agencies that are backed by the full faith and credit of the U.S. government. Direct loans to the Tennessee Valley Authority (TVA) are an exception because they are not guaranteed by the United States, however, no allowance for loan losses was required for TVA as of September 30, 1988.

Retained Earnings Transferred to the U.S. Treasury

In August 1981, the Board of Directors authorized the Bank's Treasurer to pay to the General Fund of the Treasury, as soon as practicable after each calendar quarter, any cash in excess of the amount required to cover expenses, plus $1 million to be held as a contingency reserve.

Transfers totaled $200 million in fiscal year 1987. In 1988, however, no funds were transferred due to losses incurred in the current year.

Related Parties

The Bank is subject to the general supervision and direction of the Secretary of the Treasury. As provided by law, the Secretary of the Treasury acts as Chairman of the Board of Directors. The Bank's management functions are performed by employees of Treasury's Departmental offices; its legal counsel is Treasury's General Counsel; and its accounting operations are conducted by Treasury's Financial Management Service (FMS). The Bank reimburses Treasury for facilities and services.

2. Loans Receivable

Loans receivable include agency loans purchased, loans to nonfederal entities, the repayment of which is usually guaranteed by an agency, and direct loans to agencies. Agency loans purchased are either notes or pools of loans sold by federal agencies in the form of certificates representing shares of ownership in the loan pool. The selling agencies guarantee the principal and interest repayments on the notes or certificates. Loans to nonfederal entities are loans made to nonfederal borrowers whose obligation to repay the principal and interest is usually guaranteed by a federal agency. Direct loans to agencies are debt securities issued to the Bank by agencies that are authorized by Congress to borrow to finance their activities.

Loans receivable consist of the following:

	As of September 30, 1988	1987
	(in thousands)	
Agency loans purchased:		
Farmers Home Administration U.S. Dept. of Agriculture (USDA/CBO)	$ 58,496,000	$ 65,009,000
Medical Facilities, Dept. of Health and Human Services (HHS)	96,388	102,241
Health Maintenance Organizations, HHS	85,323	90,044
Overseas Private Investment Corp.	0	680
Rural Electrification Administration (USDA/CBO)	4,139,207	4,241,207
Small Business Administration (SBA) Local Development Companies	17,130	21,879
Total agency loans purchased	62,834,048	69,465,051

2. Loans receivable (continued)

	As of September 30, 1988	1987
	(in thousands)	
Loans to nonfederal entities:		
Defense Security Assistance Agency	$ 16,087,512	$ 19,163,977
Ormesa Geothermal, Dept. of Energy (DOE)	49,980	0
General Services Administration	474,524	488,104
Guam Power Authority, Dept. of the Interior (DOI)	32,105	33,180
Community Development Block Grants Dept. of Housing and Urban Development (HUD)	318,059	324,249
New Community Development Corp., HUD	0	30,575
Low Rent Public Housing, HUD	2,037,036	2,076,517
Spacecom, National Aeronautics and Space Administration	915,248	1,011,020
Ship Leasing, Dept. of Defense, Navy	1,758,872	1,788,263
Rural Electrification Administration, Rural Utilities	19,205,317	21,196,923
State/Local Development-503, SBA	870,880	899,776
Small Business Investment Corp., SBA	632,681	740,605
Seven States Energy Corp., TVA	2,162,389	1,823,676
Student Loan Marketing Assoc., Dept. of Education	4,910,000	4,940,000
Virgin Islands, DOI	26,572	27,159
Washington Metro Area Transit Authority, Dept. of Transportation (DOI)	177,000	177,000
Railways 511, DOT	46,201	55,388
Total loans to nonfederal entities	49,704,376	54,776,412
Direct loans to agencies:		
Export-Import Bank of the U.S.	10,957,619	12,463,465
Tennessee Valley Authority	17,131,000	16,386,000
National Credit Union Admin.	118,148	111,394
U.S. Postal Service	5,592,200	4,353,400
Total direct loans to agencies	33,798,967	33,314,259
Discount - net	(7,565)	(8,377)
	$146,329,826	$157,547,345

3. Borrowings

The Bank finances its loan portfolio primarily by borrowing from the Treasury. Under the Federal Financing Bank Act of 1973, the Bank may, with the approval of the Secretary of the Treasury, borrow without limit from the U.S. Treasury. At September 30, 1988, the bank had outstanding advances owed to Treasury of $131.7 billion, with interest rates ranging from 5.90 percent to 16.06 percent, and maturity dates ranging from October 1, 1988, to December 31, 2020.

Additionally, the Bank had outstanding borrowings of $14.8 billion from the Civil Service Retirement and Disability Fund, which is administered by the Office of Personnel Management. These borrowings are at interest rates ranging from 8.75 percent to 13.75 percent, and with maturity dates ranging from June 30, 1989, to June 30, 2003.

4. Debt Prepayment Premium

Under the terms of the majority of the Bank's loans, borrowers may repurchase their loans at a price reflecting changes in the loan value. These changes generate premiums and discounts at the time of the repurchase.

Under the terms of the master promissory note between the Bank and the Treasury, the Bank may repurchase the loans from the Treasury in accordance with the terms of each loan. There is no financial effect on the Bank from the premiums/discounts derived from prepayments in accordance with contracted terms. For the years ended September 30, 1988 and 1987, borrowers paid $12.7 million and $129 million in premiums and received $1.0 million and $388,000 in discounts on loan prepayments, respectively. These amounts were passed through to the Treasury Department and thus are not reflected in the Bank's financial statements.

Public Law 100-203, authorized certain borrowers having loans guaranteed by the Rural Electrification Administration (REA) to prepay their loans at par value (book value) up to a specified dollar limit. Also, Public Law 100-202 authorized borrowers in the foreign military sales program guaranteed by the Defense Security Assistance Agency (DSAA) to prepay at par (book) value, loans meeting certain specific criteria. The legislation precluded the Bank from enforcing provisions in the loan notes that require the loans to be prepaid at their then current market value, which results in the above discounts/premiums that are passed through to Treasury. However, these Congressional actions did not amend the terms of the contract between the Bank and the Treasury, and do not provide the Bank with rights to prepay its Treasury borrowing in ways other than under the terms of the agreement existing between the Bank and the Treasury. Therefore, if the Bank elects to prepay Treasury it must pay to the Treasury the unaltered contractual value of the debt in order to fully prepay the debt. The difference between the market value of the debt prepaid to Treasury and the debt's book value resulted in a loss to the Bank.

In fiscal year 1988, loans having a total principal value of $2 billion for the REA program, and $2.5 billion for the DSAA program were prepaid. Had the Bank not been precluded from enforcing the prepayment provisions of the notes, the borrowers would have had to pay an additional premium of $472 million in 1988 for REA-guaranteed loans and $814 million for DSAA-guaranteed loans. Nonetheless, because it prepaid its related debt to Treasury, and this invoked the prepayment provisions in its debt agreement with Treasury, the Bank owes these amounts to Treasury. In addition, the Bank incurred interest expense of $29 million in fiscal year 1988 because it did not have the funds to pay the prepayment premium. Accordingly, the Bank recognized $1.3 billion and $165 million in fiscal years 1988 and 1987, respectively, for premiums and interest due to prepaying Treasury debt.

5. Commitments and Contingencies

Additional foreign military sales loan prepayments under the provisions of Public Law 100-202, as described above, are possible for fiscal year 1989. It is estimated that an additional $2.5 billion in loans could be prepaid. Since the Bank is unable to estimate the amounts that may be prepaid and the associated losses, no charge against fiscal year 1988 income has been recorded.

As of September 30, 1988 and 1987, there were $25.2 billion and $15.6 billion, respectively, of loan commitments.

6. Supplemental Disclosure of Cash Flow Information

	For the year ended September 30, 1988	1987
	(in thousands)	
Cash received during the year from interest income	$16,989,069	$17,054,418
Cash paid during the year for interest expense	16,669,529	16,641,870

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