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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Reviews Of The Audits Of The National Credit Union Administration Central Liquidity Facility's Financial Statements For The Years Ended September 30, 1983 And 1982

GAO reviewed the independent certified public accountants' audits of the National Credit Union Administration Central Liquidity Facility's financial statements for the years ended September 30, 1983 and 1982. GAO found nothing to indicate the opinions of the independent certified public accountants are inappropriate or cannot be relied on.

In the opinion of the Facility's independent certified public accountants, the financial statements present fairly the Facility's financial position as of September 30, 1983 and 1982, the results of its operations, and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied.



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

B-204227

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

This report presents the results of our reviews of Price Waterhouse's audits of the balance sheets of the National Credit Union Administration Central Liquidity Facility as of September 30, 1983 and 1982, and the related statements of operations and retained earnings, and changes in financial position for the years then ended. Our reviews were made under provisions of the National Credit Union Central Liquidity Facility Act (12 U.S.C. 1795h), which directs us to audit the Facility.

Our reviews were conducted in accordance with generally accepted government auditing standards. To avoid unnecessary duplication and expense and make the most efficient use of our available resources, we relied on the work and reports of the Facility's independent certified public accountants rather than conduct financial audits ourselves. To review the reasonableness of the auditors' work and determine the extent to which we could rely on it, we

- interviewed the Facility's officials to obtain information about the Facility's operations, including the maintenance of its financial records and the preparation of its financial statements;
- interviewed the auditors to identify the audit approach used and the methods used to control the quality of audit work;
- obtained information about the qualifications and independence of the auditors;
- reviewed the Facility's financial statements and the auditors' reports for compliance with the reporting requirements of generally accepted accounting principles and generally accepted auditing standards; and
- reviewed the auditors' workpapers to determine:
 - o the nature, timing, and extent of audit work performed;
 - o whether the audit quality control methods identified by the auditor were actually used;
 - o whether there was a proper study and evaluation of the Facility's internal controls; and

- o whether the auditors tested transactions for compliance with applicable laws and regulations.

We found that the audits were conducted in accordance with generally accepted auditing standards.

In the opinion of Price Waterhouse, the Facility's financial statements present fairly its financial position as of September 30, 1983 and 1982, the results of its operations, and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied. During our reviews, we found nothing to indicate Price Waterhouse's opinion on the Facility's 1983 and 1982 financial statements is inappropriate or that it cannot be relied on.

Price Waterhouse did not prepare the reports on internal accounting controls and compliance with laws and regulations required by generally accepted government auditing standards because its contract with the Facility did not require such reports. However, Price Waterhouse did study and evaluate internal accounting controls and test transactions for compliance with key laws and regulations. Its work did not disclose any material internal control weaknesses or noncompliance with laws and regulations. The opinion and financial statements are in appendix I.

We are sending copies of this report to the Director of the Office of Management and Budget, the Secretary of the Treasury, and the National Credit Union Administration's Board of Directors.



Comptroller General
of the United States



1801 K STREET, N.W.
WASHINGTON, DC 20006
202 296-0800

November 18, 1983

To the Board of the National Credit
Union Administration and
the National Credit Union Administration
Central Liquidity Facility

In our opinion, the accompanying balance sheets and the related statements of operations and retained earnings and of changes in financial position present fairly the financial position of the National Credit Union Administration Central Liquidity Facility at September 30, 1983 and 1982, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Price Waterhouse

NATIONAL CREDIT UNION ADMINISTRATIONCENTRAL LIQUIDITY FACILITYBALANCE SHEETS

(Expressed in thousands of dollars)

(Notes 1 and 2)

	<u>September 30,</u>	
	<u>1983</u>	<u>1982</u>
<u>ASSETS</u>		
Cash	\$ 23	\$ 46
Investments (Note 5)	96,742	89,244
Loans to members less allowance for loan losses of \$1,149 at September 30, 1982 (Notes 2 and 4)	44,800	129,330
Accrued interest receivable	3,061	2,690
Other assets	61	132
Total assets	<u>\$144,687</u>	<u>\$221,442</u>

LIABILITIES AND EQUITY

<u>Liabilities</u>		
Notes payable (Note 7)	\$ 44,200	\$130,066
Member deposits (Note 8)	10,681	16,845
Accrued interest payable	593	1,995
Accounts payable and other liabilities	105	188
Federal income taxes payable (Note 10)	1,112	
Total liabilities	<u>56,691</u>	<u>149,094</u>
<u>Equity</u>		
Capital stock - required (Note 8)	86,373	72,139
Retained earnings	1,623	209
Total equity	<u>87,996</u>	<u>72,348</u>
<u>Commitments and contingencies</u> (Notes 4, 10, 12 and 13)		
Total liabilities and equity	<u>\$144,687</u>	<u>\$221,442</u>

NATIONAL CREDIT UNION ADMINISTRATION
CENTRAL LIQUIDITY FACILITY
STATEMENTS OF OPERATIONS AND RETAINED EARNINGS
(Expressed in thousands of dollars)
(Notes 1 and 2)

	<u>Year ended September 30,</u>	
	<u>1983</u>	<u>1982</u>
Income		
Interest on loans	\$ 8,833	\$10,653
Income from investments	9,071	12,036
	<u>17,904</u>	<u>22,689</u>
Expenses		
Personnel services	294	383
Personnel benefits	45	38
Employee travel	17	28
Shipping and delivery	4	6
Rent, communications and utilities	50	93
Printing and reproduction	14	24
Other services	181	425
Supplies and materials	4	7
Depreciation and amortization		267
Other, principally write-off of organization costs (Note 6)		646
	<u>609</u>	<u>1,917</u>
Interest		
Federal Financing Bank	7,836	10,180
Member deposits	1,048	1,572
Provision for loan losses (Note 2)	(1,149)	1,149
	<u>8,344</u>	<u>14,818</u>
Income before income taxes	9,560	7,871
Income taxes (Note 10)	1,189	3
Net income	8,371	7,868
Dividends to members (Note 8)	6,957	7,853
Addition to retained earnings	1,414	15
Retained earnings at beginning of period	209	194
Retained earnings at end of period	<u>\$ 1,623</u>	<u>\$ 209</u>

NATIONAL CREDIT UNION ADMINISTRATION
CENTRAL LIQUIDITY FACILITY
STATEMENTS OF CHANGES IN FINANCIAL POSITION
(Expressed in thousands of dollars)

	<u>Year ended September 30,</u>	
	<u>1983</u>	<u>1982</u>
Cash and investments were provided by:		
Operations		
Net income	\$ 8,371	\$ 7,868
Add (deduct) items not affecting cash and investments during the year:		
Depreciation and amortization		267
Provision for loan losses	(1,149)	1,149
Other, principally write-off of organization costs		646
	<u>7,222</u>	<u>9,930</u>
Issuance of required capital stock	18,682	10,428
Addition to member deposits	22,743	40,226
Borrowings	461,541	132,766
Increase in Federal income taxes payable	1,112	
Loan repayments	280,125	52,304
Total cash and investments provided	<u>791,425</u>	<u>245,654</u>
Cash and investments were used for:		
Redemption of required capital stock	4,448	5,631
Withdrawal of member deposits	28,906	37,512
Dividends	6,957	7,853
Borrowing repayments	547,407	103,973
Loan disbursements	194,446	81,758
Other, net	1,786	(1,245)
Total cash and investments used	<u>783,950</u>	<u>235,482</u>
Increase in cash and investments	<u>\$ 7,475</u>	<u>\$ 10,172</u>

NATIONAL CREDIT UNION ADMINISTRATION
CENTRAL LIQUIDITY FACILITY
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 1983 AND 1982

Note 1 - Organization and Purpose

The National Credit Union Administration Central Liquidity Facility ("the CLF") was created by the National Credit Union Central Liquidity Facility Act ("the Act"). The CLF is designated as a mixed-ownership government corporation under the Government Corporation Control Act. It exists within the National Credit Union Administration and is managed by the National Credit Union Administration Board. The CLF became operational on October 1, 1979.

The purpose of the CLF is to improve general financial stability by meeting the liquidity needs of credit unions.

Note 2 - Significant Accounting Policies

Basis of Accounting

The CLF maintains its accounting records on the accrual basis of accounting.

Allowance for Loan Losses

Loans to members are made on both a short-term and long-term basis. The CLF obtains a security interest in the assets of the borrower on all loans.

The CLF evaluates the collectibility of its loans to members through examination of the financial condition of the individual borrowing credit unions and the credit union industry in general. An allowance for loan losses in the amount of \$1,149,000 was

established for loans outstanding at September 30, 1982. Due to the improved financial condition of the borrowing credit unions, the pledged security and guarantee on outstanding loans, and the retirement of prior year outstanding loan balances, this allowance was reversed and no allowance was considered necessary for loans outstanding at September 30, 1983.

Investments

All of the CLF's investments are short-term with no maturities in excess of one year. These investments are recorded at cost, which approximates market value.

Note 3 - Government Regulations

The CLF was created by the Act and is subject to various Federal laws and regulations. The CLF's operating budget requires Congressional approval and the CLF may not make loans to members for the purpose of expanding credit union loan portfolios. The CLF's investments are restricted to obligations of the United States Government and its agencies, deposits in federally insured financial institutions and shares and deposits in credit unions. Borrowing is limited to the lesser of \$600 million or twelve times equity and capital subscriptions on-call. At September 30, 1983 and 1982, the CLF was in compliance with these limitations.

Note 4 - Loans to Members

Loans are made only to member credit unions. These loans carry interest rates which ranged from 9.95% to 11.03% at September 30, 1983 (8.69% to 12.81% at September 30, 1982). The loans mature as follows (dollars in thousands):

<u>Maturing in fiscal year</u>	<u>September 30,</u>	
	<u>1983</u>	<u>1982</u>
1983		\$ 52,916
1984	\$44,800	77,563
	<u>44,800</u>	<u>130,479</u>
Less allowance for loan losses (Note 2)		(1,149)
	<u>\$44,800</u>	<u>\$129,330</u>

The CLF may also provide members with 90-day loan commitments. At September 30, 1983 there were approximately \$147,000,000 in outstanding commitments (\$26,600,000 at September 30, 1982).

Note 5 - Investments

Funds not currently required for operations were invested as follows (dollars in thousands):

	<u>September 30,</u>	
	<u>1983</u>	<u>1982</u>
Time deposits	\$88,000	\$77,000
Share certificates of members	8,242	9,644
Overnight securities	500	2,600
	<u>\$96,742</u>	<u>\$89,244</u>

Note 6 - Write-off of Organization Costs and Fixed Assets

Prior to 1982 it was the policy of the CLF to amortize organization costs over 5 years and depreciate fixed assets over lives ranging from 3 to 10 years. During the 1982 fiscal year, the CLF continued to record amortization and depreciation (amounting to \$267,000 as of September 30, 1982) of organization

costs and fixed assets, respectively. At September 30, 1982, however, these assets were deemed to have no further future value. Accordingly, their remaining unamortized book value of \$646,000 was written-off and is presented separately as a charge to income in the statement of operations and retained earnings.

Note 7 - Notes Payable

Substantially all of the CLF's borrowings have been from the Federal Financing Bank. The interest rates on these obligations are fixed and range from 9.6% to 10.0% at September 30, 1983 (7.4% to 11.8% at September 30, 1982). Interest is generally payable upon maturity. These notes mature as follows (dollars in thousands):

<u>Maturing in fiscal year</u>	<u>September 30,</u>	
	<u>1983</u>	<u>1982</u>
1983		\$ 78,466
1984	\$44,200	51,600
	<u>\$44,200</u>	<u>\$130,066</u>

The Secretary of the Treasury is authorized by the Act to lend up to \$500 million to the CLF in the event that the Board certifies to the Secretary that the CLF does not have sufficient funds to meet the liquidity needs of credit unions. This authority to lend is limited to such extent and in such amounts as are provided in advance by Congressional Appropriation Acts. On December 23, 1981 President Reagan signed PL 97-101 which provided \$100 million of permanent indefinite borrowing authority which may be provided by the Secretary of the Treasury to the CLF to meet emergency liquidity needs of credit unions.

Note 8 - Capital Stock and Member Deposits

The required capital stock account represents subscriptions remitted to the CLF by member credit unions. Regular members' required subscription amounts equal one-half of one percent of their paid-in and unimpaired capital and surplus, one-half of which amount is required to be remitted to the CLF. Agent members' required subscription amounts equal one-half of one percent of the paid-in and unimpaired capital and surplus of all of the credit unions served by the agent member, one-half of which amount is required to be remitted to the CLF. In both cases the remaining one-half of the subscription is required to be held in liquid assets by the member credit unions subject to call by the National Credit Union Administration Board. These unremitted subscriptions are not reflected in the CLF's financial statements. Subscriptions are adjusted annually to reflect changes in the member credit unions' paid-in and unimpaired capital and surplus. Dividends are declared and paid on required capital stock.

Member deposits represent amounts remitted by members over and above the amount required for membership. Interest is paid on member deposits at a rate equivalent to the dividend rate paid on required capital stock.

Note 9 - Services Provided by the National Credit Union Administration

The National Credit Union Administration provides the CLF with miscellaneous services and supplies. In addition, the employees of the CLF are paid by the National Credit Union Administration. The CLF reimburses the National Credit Union Administration on a monthly basis for most of these items. Certain services, principally data processing services, are provided to the CLF at no cost.

Total reimbursements amounted to approximately \$389,000 as of September 30, 1983 (\$513,000 as of September 30, 1982).

Note 10 - Income Taxes

Legislation has been proposed in Congress that would exempt the CLF from Federal, State, municipal and local taxation, except taxes on real property. At the date of these financial statements however, the Congress has not acted on the proposal. Further, the CLF has received an opinion by external legal counsel that a court, having the appropriate jurisdiction and authority, would determine the CLF to be exempt from income taxation both under the Internal Revenue Code and the laws of the District of Columbia.

The Department of the Treasury however, has indicated that specific legislation is required for the CLF to become exempt from Federal income tax. Additionally, in July 1982 the Internal Revenue Service ("the IRS") disallowed the CLF's claim for refund of approximately \$162,000 of Federal income taxes paid for the 1981 and 1980 fiscal years, finding that the CLF is not exempt from Federal income tax.

The CLF appealed this decision with the IRS. However, the IRS reaffirmed its position and disallowed the CLF's refund claim. Additionally, the IRS has stated that unless legislation is passed by December 31, 1983, exempting CLF from taxation, IRS statutory notices of claim disallowance will be issued at which point CLF will have two years to file suit for recovery of taxes paid.

However, until specific legislation is passed by Congress or a favorable determination is obtained from a court of law, the CLF is obligated to pay income taxes. A provision for income taxes has been recorded by a charge to income in the financial statements.

Taxable income differs from net income as shown in the statement of operations and retained earnings primarily by the amount of dividends paid to members, which are deducted as an expense for tax purposes.

Note 11 - Pension Plan

The employees of the CLF are participants in the Civil Service Retirement Plan. The Plan is a contributory defined benefit pension plan covering substantially all of the employees of the CLF. Pension expense for the years ended September 30, 1983 and 1982 was approximately \$20,300 and \$24,400, respectively.

Note 12 - Lease

The CLF leases office space jointly with the National Credit Union Administration under a non-cancellable operating lease expiring in 1994. Under the terms of this lease, the CLF and the National Credit Union Administration are jointly and severally liable for future minimum lease payments as of September 30, 1983, as follows (dollars in thousands):

<u>Year ended September 30,</u>	
1984	\$ 886
1985	964
1986	980
1987	980
1988	980
Thereafter	6,148
	<u>\$10,938</u>

The CLF's portion of these lease payments (rent expense) for the years ended September 30, 1983 and 1982 was \$26,900 and \$36,400, respectively.

Note 13 - Subsequent Event

On October 4, 1983, the National Credit Union Administration Board approved in principle a membership request from U.S. Central Corporate Credit Union on behalf of 29 of its corporate credit union members. This will substantially increase membership in the CLF.

In addition, by accepting this request, the CLF is initially committed to reinvest all but \$50,000,000 of its total share capital in U.S. Central share accounts at near market rates of interest.



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