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DIAGNOSTIC REVIEW
OF OPERATIONS AT THE
CZECH SAVINGS BANK

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Washington, D.C.

March, 1993

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INTRODUCTION

This report presents the results of the initial review and evaluation of the operations of the Czech State Savings Bank (CSB or Bank) conducted by KPMG Peat Marwick. This work was conducted under a contract with the United States Agency for International Development to provide technical assistance related to the privatization and restructuring of the Bank. The information presented in this report is a compilation of the results of a series of operational evaluations conducted over a period of approximately six months during 1992. This review covered four major areas within the Bank which were the focus of the technical assistance program:

- (1) Credit analysis and risk management;
- (2) Investment fund operations;
- (3) Financial management and controls; and
- (4) Foreign exchange and foreign payments.

An initial review of the Bank's operations in each of these areas was conducted in two stages at the beginning of the project: First, a review team visited the bank over a two-week period in February, 1992; this was followed by a more detailed review in April and May of 1992. These reviews were designed to identify the areas where the resources of the technical assistance program should be focused and to establish the priorities for the program.

The initial review resulted in a plan for focusing the early activities under the technical assistance program which heavily targeted the newly-created Investment Division of the Bank. This particular focus of the work was based upon the unprecedented voucher privatization program that was being implemented in what was then Czechoslovakia, and the Bank's position as one of the institutions that would clearly emerge as a major player in this process. The relative rapidity with which the voucher privatization program was being implemented, coupled with the almost complete lack of infrastructure or experience in investment fund management and operations at the Bank, placed this program at the center of the technical assistance effort.

More detailed diagnostic evaluations in each of the four areas listed above were conducted over time as work was initiated in these sections of the Bank. These evaluations were based upon:

- (1) In-depth interviews with the staff at all levels of the

Bank;

- (2) Reviews of financial and operating information provided by the Bank; and
- (3) Site visits to District, Regional and Branch offices.

The information collected during these diagnostic reviews is described in the following sections of this report. Each major section is organized into five major parts:

- Organization
- Staffing
- Systems and Procedures
- Workload
- Conclusions

This information represents the baseline from which the technical assistance program can be measured.

CREDIT ANALYSIS AND RISK MANAGEMENT

Overview:

The diagnostic review of the credit function within the Czech Savings Bank began in April, 1992. The review process started with in-depth discussions with the Director of the Commercial Division (the de facto senior credit officer within the Bank) and staff at the headquarters level. This was followed by visits to two Divisional Branches and a Regional office. During these visits credit files, presentation formats, and credit analysis were reviewed. There was also a review of both national banking regulations and the Bank's internal regulations and procedures governing credit approval.

During the 3rd quarter 1992, continuing discussions were held at the headquarters level concerning the credit review and problem loan workout functions as well as observing the credit approval process in action. In the 4th quarter 1992, there were two visits to Divisional Branches for a more in-depth review of credit approval procedures and controls at the branch level.

In the first quarter of 1992, the Bank did not place a high priority on technical assistance in the credit area. This was due to a number of environmental factors, including that much of the banks lending activity was focused on interbank lending, that business loans comprised very little of the portfolio at the time, and that there was a credit limit imposed on the Savings Bank by the State Bank which was effectively placing a moratorium on further lending. A summary of the Bank's assets at the end of 1991 with changes for the year is presented in the tables on the following page.

I. Organization of the Credit Function

A. Findings

The credit approval function within the CSB is based on loan origination at one of the 73 District Branches, or in exceptional cases at one of the 8 Regional levels or the Headquarters level. Loans can be approved at the District, Regional or Headquarters level depending upon the amount of the request; the largest requests have to

CSSB Balance Sheet, Year End 1991

| Asset Type | KCS | US\$ | Percent of | Percent |
|------------------------|------------|----------|------------|---------------|
| | Millions | Millions | Total | Annual Growth |
| Individual Loans | Kcs 6,242 | \$ 219 | 3% | (8)% |
| Social Loans | 29,517 | 1,036 | 12 | 18 |
| Business Loans | 29,173 | 1,024 | 12 | 289 |
| TOTAL | Kcs 64,932 | \$ 2,279 | 27 | 13 |
| Loan/Depos it to Banks | 169,477 | 5,947 | 69 | 11 |
| Other Assets | 11,161 | 391 | 4 | 450 |
| Total Assets | 245,570 | \$ 8,617 | 100% | 27% |

Source: Czech State Savings Bank Annual Report for 1991 and information provided by Bank management.

| | | |
|---------------------------------------|-------------|-----------|
| Average loan size of individual loans | Kcs 3,470 | \$ 122 |
| Average loan size of business loans | Kcs 884,000 | \$ 31,000 |
| Number of loans to individuals | 1,612,000 | |
| Number of loans to business | 33,000 | |

Source: Czech State Savings Bank Annual Report for 1991 and information provided by Bank management.

be approved by the Board of Directors. Although the Director of the Commercial Division is the nominal head of the credit function, in fact the Divisional Branches and the Regions run independent credit approval operations within their respective delegated authorities. The current structure does not have, nor could it most likely accommodate a Credit Review Department, a Problem Loan Workout Department, or a Credit Policies and Procedures Committee.

The current structure is also a function of historic divisions and political control within the Bank. These attitudes may prove difficult to overcome.

B. Conclusions:

The current overall structure is both ineffective and inefficient. The credit process is understaffed (e.g. the Director of the Commercial Division has a professional staff of only two persons). In most cases the members of the Board of Directors do not have the skill levels necessary to approve large and complex credits. In order for the Czech Savings Bank to be able to meet the challenges of the changing economy, a complete restructuring of the credit approval and risk management process will be required.

II. Staffing

A. Findings

1. Number of Staff

There are approximately 120 individuals with various levels of credit approval authority. The majority of these individuals are located in the 73 District Branches. There are three individuals at the Headquarters level, including the Director of the Commercial Division.

2. Experience

" Prior to 1991, the Czech State Savings Bank did not engage in large scale, wholesale lending, therefore the experience level of the credit officers is understandably concentrated on the retail end of lending activity. For example, approximately half of the Bank's loan portfolio was in low denominated so-called "Social Loans", repayment for which was automatically deducted from the borrower's paycheck

plus being supported by a guarantee from another family member. There is an almost complete lack of experience in analyzing credit risk, interest rate exposure, and foreign exchange risk. A few individuals have been brought in from outside of the Bank, but the experience level has not measurably improved.

There are virtually no English language skills in the Department. Lack of English speakers and discomfort with foreign advisors due to lack of western-style credit experience among the credit staff were frequently sifted as reasons for proceeding slowly with the technical assistance effort in the credit area.

3. Training

Training has been either non-existent or inadequate for an organization about to engage in universal banking. Part of this is a result of the previous system as it existed under a centrally-planned economy and state ownership of the means of production; individual credit risk did not exist and thus analytical skills were not required.

B. Conclusions

Staffing is inadequate in terms of number, experience, and training for an organization that has begun to offer universal banking products and is now engaged in large, wholesale corporate lending. While senior management recognizes there are inadequacies and desires to increase the skill level of its personnel, it is not certain that they recognize the depth and severity of the situation.

III. Systems and Procedures

A. Findings

The current credit approval system allows for credit requests to be approved within the 73 District Branches or at one of the eight Regional levels depending upon the amount of the credit request. If the request is more than the originating unit can approve, it must then be elevated to the next higher level. However, within the level of their approval authority, the District Branches and Regions operate as de facto independent credit approval systems. The credit approval limits vary from district to district and region to region, however, at the district level they range from 10 million kcs to 30

million kcs; at the regional level the approval limit ranges from 30 million kcs to 50 million kcs; credit applications in excess of 50 million kcs are referred to the headquarters office.

There is no downward monitoring or checks and balances on what happens within either District or Regional levels; basically, each level is self-contained. Past due interest can be rolled-over into a "restructured loan" without any notification of the next higher level.

Approval levels are set according to the amount of the loan only; there is no recognition of levels of complexity or risk as a reason to elevate a request to a higher authority.

Perhaps most importantly, the Bank does not have a system that allows the aggregation of total credit to any one borrower. That is, because District Branches and Regional authorities do not have to report loans made within their approval limits, the Bank does not have a system that allows the Bank to know the total amount of credit it has extended to any one borrower or a related group of borrowers. This also means that the Bank cannot access data that would allow it to review its loan portfolio in its entirety. Thus the Bank cannot analyze overall concentrations of risk.

There is no Risk Rating System that would function as a common, Bank-wide definition of levels of risk. Nor is there a standardized presentation format to be used for credit requests. As a result, credit analysis, background information and industry analysis is often missing or inadequate.

Several requests were made to review a sample of existing credit files, but no files have been provided to the project team to date. Therefore, it has not been possible yet to look at the type of information that is contained in these files or the format used. Anecdotal information suggests that the typical file contains little supporting analysis or detailed financial information, and that there is not standard formation for its presentation.

B. Conclusions

The current credit approval process is not only inadequate for the business activities in which the Czech Savings Bank wishes to engage, but it is also inadequate to meet the challenges of a modern bank operating in a

free-market economy. A complete reorganization of the system is required along with the installation of checks and balances, a Credit Review Department and a Problem Loan Workout Department. It is also recommended that a Credit Policies and Procedures Department be created.

IV. Workload

A. Findings

The workload throughout the credit approval process is too high for the various individuals to adequately perform their duties. As an example, Bank officers at the District Branch level often have between 300 to 400 accounts. Regional officers are expected to process 18 to 20 credit requests per week.

B. Conclusions

A realignment of workloads is required, along with the recruitment of additional, skilled credit officers.

V. Conclusions

A. KPMG has identified four broad categories in which improvement is needed in order for the CSB to meet the challenges of the changing banking environment. These are:

1. Credit approval authority and responsibility.
2. A methodology for analyzing and quantifying credit risk.
3. A methodology for formulating and monitoring credit policies.
4. Protection of bank assets.

B. Clearly, immediate improvement cannot be made in all areas at once. In some cases there needs to be not only a change in historic attitudes, but political realities within the bank must also be taken into consideration. In order to make the desired improvement in these categories, it is necessary to set out specific Tasks that will provide a systemic approach to achieving a series of related, but "stand alone" changes.

The bank has expressed reluctance to proceed with major changes at the present time in the credit management area. Throughout the review process, the project team has been told that the bank is not ready to begin work in the credit area, and that the technical assistance effort should focus on what are considered to be the more immediate needs of the Investment Division first. This can be attributed to several factors, including (a) the fact that commercial loans are not a major part of the bank's assets, and (b) the state bank has imposed a credit limit which the bank has reached and which has therefore caused a moratorium on new lending.

INVESTMENT FUND OPERATIONS

Overview:

In 1992, having recently been granted a Universal Banking License to provide both banking and securities underwriting services, the Czech State Savings Bank (CSSB) was making plans to become very active in all areas of capital markets activities. Other than investment analysis and strategy for the voucher privatization fund, however the Bank was considering plans for large scale entry into the areas of brokerage, underwriting, trading and financial services provider.

At this time, the entire financial sector was operating in a vacuum. There was:

1. No stock exchange or stock exchange rules;
2. No Investment Company Act;
3. No Securities Laws or clearly defined regulatory commission;
4. No Banking Regulations, Commercial Codes and Accounting Rules;
5. Paralysis by the major financial institutions and governmental ministries over the political situation of Czechoslovakia; and
6. Poor or no financial information regarding all companies involved in the first round of privatization.

The following was undertaken to gain a better understanding of the needs of CSB and the financial sector in the capital markets area;

1. Interviews with CSB management in all areas of securities trading and processing;
2. Interviews with management of the State Bank, Finance Ministries, and Stock Exchange; and
3. Translation and analysis of drafts of all official documents.

The findings and conclusions of the initial diagnostic review conducted by KPMG Peat Marwick in April, 1992 are described below.

I. Organization of the Investment Funds

A. Findings

All capital markets activities, including the investment funds, are organized under the newly established Investment Division of the Bank. This Division also includes the Letter of Credit and Foreign Exchange Departments. There are immediate plans to create separate corporate subsidiaries for the voucher privatization fund and the open end mutual funds. Other capital markets activities such as brokerage and underwriting are to remain directly part of the Bank.

Complete control of all capital markets activities is under one member of the CSB Board of Directors. There is little formal organization below him with one other senior executive controlling most daily operations. Most of the employees in the Division are part of the voucher privatization fund area and operate in some sort of analytical capacity.

B. Conclusions

A formal organization needs to be put into place immediately within the Bank with clear and precise reporting structures. Senior management will need to remove themselves from the daily operations and concentrate fully on the strategic planning of the capital markets functions within the Bank. Focus has to be given to the setting of financial and operational goals, investment objectives, work standards and staff training.

II. Staffing

A. Findings

1. Number by Function

Investment Fund and Capital Markets functions have a staff of approximately 30 individuals. Although not formally organized, the functions they perform include:

- Investment Fund Portfolio Management and Analysts - 15 staff members
- Investment Fund and Capital Markets Operations - 12 staff members
- Systems and Programming - 3 staff members

2. Experience

Virtually none of the staff in place have had formal training or experience in the specific duties for which they are responsible. Most had a peripheral knowledge of their functions from text books or other readings. Some staff in key positions have been with the Bank for as little as one to three months. The Board Member responsible for the Division has only been with the Bank for 8 months and has no previous investment experience.

3. Training

No formal training program exists for staff in the Investment Division. Some staff members have visited correspondent bank partners of CSSB for a day. One has participated in a 3 week securities trading program organized by the Know How Fund in London.

B. Conclusions

The staffing situation in the CSB Investment division is very poor. Although eager to learn, staff at all levels have little realization of what they don't know and the time commitment that will be required to learn. Many maintain the work habits and outlooks on their jobs as they did under the old regime. With the start of capital markets trading, the Bank could be in a position of great financial risk as staff members with little or no training would be participating in securities trading -- placing both Bank and Investment Fund monies in jeopardy. Operationally, the Bank is not in a position to technically interface with the trading markets since systems staff are not available to focus on the issues.

There are no immediate plans for formal staff training or hiring due to office space shortages within the Bank.

III. Systems and Procedures

A. Findings

The Czech State Savings Bank as well as the other investment funds are looking to the government to provide answers for most operational and systems requirements. There appears to be little leadership by the financial community on processing or systems issues.

Within the CSSB there is little systems and automation coordination among the operating groups. Each department is talking to computer vendors independently without any thought of how these systems will interact, whether they will be compatible with current and future systems or whether there is an actual need for the system that is being considered. The Bank has made progress in the development of their own system to send orders for the open end funds from the branches to headquarters and subsequent recordkeeping. This system is very simple and does not have the capability to perform most basic functions for proper investment processing and recordkeeping.

The Bank is on the verge of signing a major multimillion dollar contract with the systems provider Unisys. The general perception of most staff members at this time is that the Unisys system would address and resolve most systems needs. The project team has offered to review the proposed contract to provide technical advice and guidance, but this offer has not been accepted.

B. Conclusions

The CSSB Investment Division needs to bring some organization and focus to their systems and processing needs. One individual should be given the responsibilities of systems director to coordinate systems analysis, development, purchase and implementation. Contact should be made with the overall CSB systems coordinator to discuss time frames and system's requirements for the implementation of the Unisys system.

Plans need to be made for the coordination and establishment of procedures for the following functions:

1. Shareholder recordkeeping for shareholders of the voucher fund, the open end funds and the shareholders of the Czech Savings Bank;
2. Custody and Administration for the investment funds and retail customers;
3. Safekeeping for the investment funds, retail customers and CSB's own account;
4. Portfolio accounting for the investment funds and CSB's own account;
5. Portfolio management MIS for the investment

funds and CSB's own account;

6. Security ordering for the branches and headquarters on the primary and secondary markets;
7. Trading and underwriting;
8. Internal monetary settlement within CSB for securities transactions and;
9. External clearing system settlement for CSB with the trading markets and State Bank.

IV. Workload

A. Findings

1. Portfolio Management and Analysis

An analysis of the over 1,200 companies to be privatized during the first wave of privatization must be completed within a two month period of time. In addition, portfolio management and bidding strategies need to be developed to ensure the utilization of all voucher points allocated to the CSB privatization fund.

CSB is also in the process of developing open end funds and has just completed a first draft of the prospectus for fund implementation in July.

2. Systems/Programming

The primary responsibility of the systems area is the internal development of the open end fund order entry and recordkeeping system. This group is also responsible for the set up and support of all personal computers and related software within the Investment Division.

3. Trading/Underwriting

The capital markets are not active. Staff in these areas currently assist in the analysis work for the privatization funds.

4. Operations

Staffs in the areas of shareholder transaction processing, portfolio accounting and custody are

attempting to understand and clarify the various securities regulations for the proper set up of their departments.

B. Conclusions

The workload facing the Investment Division is very heavy. The inexperience and lack of knowledge of the issues they are confronted with adds to the difficulty currently facing the division.

The problem of how to analyze the large number of companies with limited staff is a major constraint.

It is recognized by Bank management that work loads will increase as the trading markets start operating and products become more sophisticated.

V. Conclusions

Immediate technical assistance should focus on training management of the Investment Division in basic business and operational principles. Primary focus would be on the development of processes to address the following :

- (1) Staffing requirements
- (2) Training requirements
- (3) Equipment requirements
- (4) Division expense
- (5) Division revenues
- (6) Division performance standards
- (7) Project management
- (8) Financial asset needs

Technical assistance in the Investment Division should be in the following major areas:

- (1) Investment analysis and portfolio management
- (2) Operations and systems

(3) Trading and underwriting

1. Investment Analysis and Portfolio Management

Training is needed in all areas of basic financial analysis similar to the training to be developed in the credit functions.

2. Operations and Systems

A systems requirement document needs to be developed for all areas of processing to include:

- Shareholder recordkeeping
- Custody
- Safekeeping
- Portfolio accounting
- Portfolio management
- Security ordering
- Settlement systems

In addition, evaluations should be made of the processing procedures for all operating areas.

3. Trading and Operations

Basic technical training is needed in the operations of new equity and debt offerings. Focus should also be given to the sale of these new issues and proper risk analysis for CSB dealing on its own account.

FINANCIAL MANAGEMENT AND CONTROLS

Overview:

KPMG's initial evaluation of the CSB's Financial Management functions began in February, 1992. This evaluation was accomplished through interviews with CSB Directors and personnel within their Prague headquarters and by site visits to various branches in Czechoslovakia. KPMG also requested and received the following information from the CSB.

1. Summary balance sheet projection - 1992
2. Summary income statement projection - 1992
3. Summary change in capital projection - 1992
4. Summary source and uses of funds projection - 1992
5. Summary sources and uses of funds for fixed assets projection - 1992
6. Detail of planned capital investment projects - 1992
7. Monthly report of assets and liabilities at the branches - year-to-date 1992
8. Annual Report
9. Strategic plan for 1991 - 1994
10. Regulations on internal management system for 1992
11. Economic Plan of the CSB for 1992

I. Organization

A. Findings

1. The Bank's Economics Department is the closest equivalent of a financial division. It is responsible for reporting to the Bank's major regulator, the State Bank, for developing economic forecasts and headquarter's budget, and for the investment of the Bank's interbank portfolio.
2. Unlike a western-style financial division, the Bank appears to have no centralized accounting and control department. Different areas of the Bank

are responsible for their own parts of the general ledger.

3. There also does not exist an asset/liability management department. Interest rate and liquidity risk are neither reported on nor managed.
4. Each of the 72 district branches functions as a nearly autonomous entity, with the headquarters acting much as an upstream correspondent, providing services and systems to the districts, rather than managing them.
5. Bank "regulations" (which are basically procedures manuals) are updated and maintained by the Bank's Organization Department, part of headquarters. The Bank's Internal Audit Department assures that these procedures are followed.

B. Conclusions

1. Without a centralized accounting and control department, Bank management cannot receive timely, relevant financial data needed to determine the profitability of products and services and to effectively manage the Bank's capital and resources.
2. Without an asset/liability management function, the Bank cannot assess or manage its interest rate and liquidity risk.
3. The Bank's organizational structure limits its ability to determine the profitability of products and services and to ascertain the effectiveness of management.

II. Staffing

A. Findings

1. The Bank has had a difficult time hiring and nurturing qualified staff. Salary levels at the ČSSB are somewhat lower than at its smaller competitors and are regulated by the government. Foreign companies pay much higher salaries to skilled Czech workers, who are in particular demand if they have had experience in the West, or if they speak English.

2. The financial analysis and reporting experience levels of the Bank's personnel reflect its history. Before the revolution, when the Bank's only function was to gather deposits throughout the country and distribute them as dictated by the government, the Bank's main reporting needs related to numbers of accounts, transactions, and people. This general lack of profitability focus is seen at every level of management.
3. Within the Economics Department, most of the staff are veterans of the pre-revolution days, and have little to no direct experience in a for-profit enterprise. They are also unfamiliar with Western accounting methods.
4. The staff's ability to use micro computers is also lacking, as computers have only recently become available, and are still very expensive.
5. Much of the Bank's efforts regarding training are directed toward setting up a training institute in Brno; the early focus of this training will concentrate on using the proposed new Unisys system.
6. Managers do attend western-sponsored training seminars on an ad hoc basis, but there is no systematic training in financial management.

B. Conclusions

1. Sufficient qualified staff will be a continuing problem for the CSB, in all levels of financial management.
2. Senior and executive managers do not have sufficient experience in a free market to know what type of financial reporting to ask for, and more junior-level staff have no base of information to provide.
3. As competition drives the CSSB into more new lines of business, their inability to analyze profitability, risk, and management could seriously threaten the Bank's financial health.

III. Systems and Procedures

A. Findings

1. In terms of automated systems, the Bank is at least thirty years behind like-sized Western banks. With 15 million deposit accounts, most of the deposit accounting is still performed manually. An employee at the branch level makes entries onto manual ledgers, which in some cases are then mailed to a larger branch; the branch then enters the transactions onto floppy disks, which are delivered to one of three data processing locations; here the transactions are finally entered into a mainframe system.
2. Because of this and other untimely systems, the Bank only produces a full balance sheet on a month-end basis, a process which usually takes at least three weeks, and nearly always has outstanding research items.
3. The income statement that the Bank uses has only a very small number of non-interest expense line items, too few to make reasonable decisions. The interest income and expense accounts do not correspond to the balance sheet accounts in such a way as to be able to compute yields and money costs.
4. Although each of the regional branches and the headquarters produces an annual budget, they do not necessarily relate to one another. The budgets are all prepared in different formats, manually, and are not consolidated or cross-checked for reasonableness.
5. Once the budgets are prepared, they are basically filed; there is no system of budget versus actual review, and no accountability for financial performance.
6. The financial reports that the Board of Directors receives on a monthly basis are completely inadequate as a tool for financial oversight of the Bank.
7. From senior to lower levels of management, financial reporting is virtually non-existent.
8. Even within the Economics department, the construction of a detailed month-end balance sheet and income statement is very difficult.
9. The Bank has entered into a contract with a major American computer company to install mainframe

hardware and general ledger software for the Bank and its major branches. The general ledger is supposed to begin functioning in early 1993, and the system is to be fully installed by the end of 1994. Apparently, add-on systems, like financial management software, are not included in the original contract.

B. Conclusions

1. Because of the lack of automated systems, by the time management gets any financial data it is usually at least three months old; this time must be reduced if the Bank is to be able to effectively manage itself.
2. Accountability needs to be introduced into the Bank's management system. Certain areas are able to invest large amounts of the Bank's funds, without automatically sending up red flags on cyclical reports.
3. While the new data processing system is being created, micro-computer-based automated financial reports should be used to the extent possible. This can serve to educate staff in the data which will be required to define the new mainframe-based MIS, as well as begin the process of defining management structures based on financial accountability and profitability analysis.

IV. Workload

A. Findings

1. In general, the workload of the financial staff is fairly heavy, both because of the constantly changing situation in Czechoslovakia, and because of the inefficiencies in the infrastructures of both the Bank and the external environment in which it must operate.
2. Because of the untimeliness of raw financial information, the financial staff is always behind in accomplishing their tasks, further adding to their workloads.

B. Conclusions

1. With the advent of further automation, the financial staff will become more efficient, in many cases reducing processing times by factors of over

one hundred.

2. On the other hand, external factors in Czechoslovakia will remain dynamic for some time, and the Bank continues to increase in complexity.

IV. Conclusions

What the Bank needs is to completely reorganize its management structure, retrain its staff, and install automated data processing. With all of the changes taking place in the Bank and Czechoslovakia, however, a realistic approach would appear to be to make certain seed projects (as outlined below) within the Economics Department which will grow to demonstrate to executive management what kinds of new management changes are needed. At the same time, these seed projects can train staff and management in the design and use of automated financial reporting, preparing them for their mainframe system. These can also serve to help the Bank better manage itself, while the mainframe system is being created.

The seed projects might include:

1. Develop an automated interbank investments model which can be used to project cashflows of the interbank portfolio.
2. Develop a set of automated financial board reports.
3. To the extent possible, automate regulatory financial reports.
4. Assist the Bank in developing its 1993 budget and strategic plan.

FOREIGN EXCHANGE AND FOREIGN PAYMENTS

Overview:

The Foreign Payments Department of the Czech Savings Bank is actually composed of several functionally separate areas. These are:

- The letter of credit department
- The foreign payments department
- The foreign exchange department
- The foreign guarantee department.

The review of these departments began in February 1992. In fact most of these departments existed in name only and were just being organized. Prior to 1991, the Bank was only involved in domestic transactions. Therefore the Bank had absolutely no experience in any of the areas mentioned above. The Czech Savings Bank is now a universal bank and plans to be active in all banking areas. The Bank plans to develop commercial business and foreign trade will be important to these clients. Thus the Bank wants to develop necessary skills to operate internationally on a professional and safe basis.

I. Organization

A. Findings:

All of the departments within the foreign payments area report to one manager who reports to a Director of the Bank. While all of the departments are located on one floor in a relative small building, there is very little communication between the departments. For example, no staff meetings are held to talk about common problems. The State Bank of Czechoslovakia is concerned that banks that have little experience in foreign transactions be qualified prior to undertaking any live transactions. The goal is to have only professional work coming from Czechoslovak Banks. Therefore most of the transactions that the Czech State Savings Bank is involved in are with other Czech banks.

Overall activity in this area is very limited. For example the entire letter of credit department processes on average 20 applications per month. The department's role is to review the credit application that is filled out in one of the Bank's branches. After the information is checked, the Bank passes it on to one of the other Czech Banks so the Letter of Credit can be issued. The

Czech State Savings Bank actually guarantees the payment of any amounts due under the letter of credit to the issuing Czech Bank.

Activity in the Foreign Exchange Department is very low. The State Bank does not allow any positions to be taken in foreign exchange. Consequently, this department lays off all FX risk with corresponding trades at other banks.

B. Conclusions

The whole foreign payments/foreign exchange operation is in a start up phase. Complete training will be needed. Additionally, correspondent bank relationships will have to be established so transactions can be processed. However the pace at which the Czech State Savings Bank will develop these activities will be very slow. The Bank places a fairly low priority on this area because its customer base currently has only a limited need for international transactions. Additionally, because of the small volume of transactions, the departments are being established to learn rather than make an immediate profit.

II. Staffing

A. Findings

1. Number of Staff

As all of these departments are new and have a very low number of transactions; staff is very limited. For example, there is only one foreign exchange dealer, 4 staff in the letter of credit area, 2 in guaranty department and there are several in the other areas.

2. Experience

The Czech State Savings Bank has hired its foreign exchange dealer from another bank and the head of the letter of credit department has had some experience with another bank. The rest of the staff has come from other areas of the Bank and know basic bank operations.

3. Training

All types of training are needed for these departments. For the present, most of the training will come from working with the other Czech banks

that have experience in these areas. The State Bank plans to offer formal training. Because the transactions have to be issued by other banks, the staff learns whenever they make an error and after another Czech bank rejects an item.

B. Conclusions

This department needs all types of specific training. However, these departments have been given a fairly low priority for attention given the large and quickly growing risks in other areas and the relatively low customer demand. None the less, the Czech State Savings Bank feels that training is important and should be arranged latter in the year.

III. Systems and Procedures

A. Findings

Record keeping is rudimentary. It is based upon the practical experience of the department personnel and requirements of the accounting department. There are no specifically defined responsibilities. Accounting in the foreign exchange department is very limited. While the accounting department of the Bank keeps records, all foreign exchange transactions are kept in Czechoslovak Crowns. Therefore, the foreign exchange position in each currency cannot be managed. The foreign exchange trader keeps his own records in the department, however they are not audited and probably not complete.

Another problem is the way foreign currency deposits are managed. The current procedure is that weekly, the FX department sends a list of deposit rates to the branches that are authorized to take foreign currency deposits. The list gives a rate for various maturities. However, while the branch is obligated to tell the FX department the amount of the deposit, the branch is allowed to give a maturity date other than what the depositor received. Thus, each branch can, if it desires, take a time position in foreign exchange. The FX dealer is aware of this and is trying to modify the regulation. The Bank does not keep books in foreign currency.

Reconciliation also offers problems. Various areas can make deposits and charges to the Bank's foreign currency accounts with other Czech Banks. Also, the other Czech banks often take weeks to notify the Bank that there has been a drawing on a letter of credit or that funds have

been deposited in an account. Much tighter controls are needed.

B. Conclusions

It will be necessary to install proper control systems in this area. The bank will have to write procedures and set standards for the handling and monitoring of bank accounts.

IV. Workload

A. Findings

Overall the volume in all of the departments is very low. Consequently, staff levels are adequate to handle current volume. However, as volume increases, new staff will have to be hired. Plans are being made to hire trained people from other banks in the Czech Republic. However, this may not be easy, as there are few bank staff that have experience in foreign payment products.

B. Conclusions

Currently, the staff have time to correct errors and be very careful in their work. However, this will change as activity picks up. Therefore, additional procedures, training and controls are needed.

V. Conclusions

While the foreign payments department is important to the Bank, it is currently a relatively small problem as the current volume of activity is low. Additionally, the Bank is still hiring staff. If full training starts soon, many of the staff still to be hired will not get the benefit of training.

It was agreed that system planing and training of staff would be done in two levels:

- (1) First, self learning texts would be provided. The staff would read and study this material.
- (2) Second, expert help in foreign payment systems should be sent later in the year. By this time, the focus of the departments would be know and staff hired.