FEDERAL RESERVE BOARD

WASHINGTON

M.C.Elliott
Counsel.

November 22, 1916.

My dear Mr. Delano:

I have read the attached letter from Mr. Brown, Chief of the Bureau of Efficiency, dated October 16, 1916, in which he takes exception to memorandum of this office dated July 18, 1916.

It appears that my memorandum is construed as a criticism of the Bureau of Efficiency. It was not so intended. I was not aware that the present centralized system of collections and disbursements in use in the Treasurer's office was installed at the instance of this Bureau.

It was my purpose merely to call to the Board's attention the fact that Congress clearly intended that Federal reserve banks should be used as fiscal agents of the Government and that they could be used in the collection and disbursement of Government revenues to the advantage of the Government and of the banks.

In view of Mr. Brown's criticism it has seemed advisable to reply to his letter in some detail. I am accordingly handing you supplementary memorandum explaining the position of this office.

Very sincerely,

M. C. ELLIOTT

Hon. F. A. Delano,
Federal Reserve Board.

917 a

FEDERAL RESERVE BOARD

WASHINGTON

M. C. Elliott
Counsel.

November 21, 1916.

Memorandum for the Board:

In a letter dated October 16, 1916, Mr. Herbert D. Brown, Chief of the Bureau of Efficiency, takes exception to memorandum filed with the Board by this office under date of July 18, 1916.

In this memorandum the suggestion was made that the several Federal reserve banks could be used to advantage by the Government in the collection and disbursement of revenues. Briefly summarized, Mr. Brown's criticisms of this memorandum appear to be as follows:

1. That the memorandum contained several inaccuracies. These so-called inaccuracies apparently consist of the following suggestions:

(a) That checks drawn against the Treasurer of the United States are not properly scrutinized before payment.

(b) That stoppage of payment on checks and tracing of items after payment is difficult.

2. That it was not demonstrated in what way any saving in expense might result from the adoption of the plan proposed in the memorandum of July 18.

3. That the present system has all of the advantages without the disadvantages of the plan proposed in the memorandum of July 18.

4. That the adoption of the plan proposed in the memorandum of July 18 and the transfer of accounts from the Treasury to the Federal reserve banks would prevent important economies in handling the checks that can be effected if the accounts remain in Washington.

Answering these criticisms in the order in which they appear -

1. It appears from Mr. Brown's letter that the only examination of checks made by the Treasurer's office (before payment) to determine whether such checks have been properly issued and negotiated consists of a visual comparison of the signature on the check with the autograph signature of the disbursing officer kept on file for that purpose; that no examination is made to see whether the checks are dated or whether they show from what place they were drawn; that they are not examined to see whether the payee has indorsed;

whether the subsequent indorsements are regular; or whether the last indorsement is that of the bank whose transcript the check accompanies; that no examination is made to determine whether the amount shown in figures corresponds with the amount written in the body of the check; nor is any examination made to see whether the check has been altered in any way either in the figures or in the amount written in the body of the check.

Mr. Brown contends that the Auditor and not the Treasurer should examine the indorsements if this is deemed necessary; that the checks are not examined to see whether the payee has indorsed, as this would involve an extra expense to the Government of $5,000 a year; that if any irregularity in indorsement is later discovered the indorsing banks are liable and the Government runs no risk of loss.

In reply to these criticisms it is respectfully submitted -

The Government owes a Duty to the Banks to Adopt all Proper Safeguards.

Inasmuch as the Government requires depository banks and Federal reserve banks to cash its checks or warrants at par, it owes a duty to all such banks to provide every safeguard against the payment of items irregularly drawn or negotiated. The mere fact that the Government is protected and may have recourse against a prior indorser is not a justification of failure on its part to properly scrutinize checks before payment. If a forgery or irregular indorsement is promptly reported to the prior indorsers, they may take steps to protect themselves, but delay in the discovery of an irregularity makes it difficult for them to procure relief. As an evidence of this fact I am advised that there is now pending in New York a friendly suit to test the question of whether or not the Government may recover from a prior indorser on a forged check which the Treasurer's office paid, and on which the forgery was not discovered for three or four months after payment.

It appears that in this case a check was drawn for three or four thousand dollars, the signature of the drawer and first indorser both being forged. It was received from the Chase National Bank about the middle of September, 1914, and the bank allowed credit therefor the next day. The disbursing officer was simultaneously charged with the amount, which overdrew his account. This resulted in an investigation which, early in January, 1915, disclosed the forgery, at which time the Chase National Bank was directed to credit the Treasurer with the amount of the check. The bank declined and the friendly suit resulted. Except for the overdraft created it is possible that the forgery would not have been discovered as soon as it was.

I am advised that checks are frequently returned by the Auditor for the Treasury Department to the Treasurer of the United States on account of irregular indorsements; that in many instances the checks are not indorsed by the payee at all and in some cases bear no indorsement whatever.

The mere examination of the signature of the disbursing officer can hardly be said to afford proper protection to prior indorsers. To the extent that it is effective it will protect against forgeries but not against irregular negotiation. It appears that the Treasurer's office, under the present system, handles an average of ten million checks a year or an average of over thirty-three thousand a day if the force works full three hundred working days in a year. To detect irregularities in signatures by a visual comparison with guide cards necessarily involves the employment of clerks which are more or less expert in the matter of handwriting.

An individual bookkeeper in a bank having to sort and enter checks in detail naturally becomes more familiar with the signature of a depositor than is possible when a large volume of checks are merely compared with autograph signatures on cards, and if this system is to prove effective those making comparisons must be to all intents and purposes handwriting experts.

The Drawee's Scrutiny should be more Thorough
Than that of a Bank Handling the Item in Transit.

As long as a check is in transit the indorsing bank relies and may reasonably be expected to rely to a great extent on the prior indorsements. When, however, a check reaches the drawee and is to be charged up to a depositor's account the drawee should see that the check constitutes a full legal authority for its payment, and must necessarily scrutinize it with greater care than banks through which it has been sent for collection. It necessarily follows that any examination for irregularities should be made before rather than after payment.

It is true that the Auditor must pass upon the legality of the disbursement evidenced by the check, and the remitting bank, even though given credit by the Treasurer, may, nevertheless, have the item returned if the Auditor disapproves payment. It is, therefore, important that the records of the Treasurer's office should be kept so as to facilitate the tracing of items after payment, and the prompt return to the remitting bank of checks drawn ro cover unauthorized or illegal disbursements.

It is submitted, however, that before checks leave the office of the Treasurer they should be carefully examined to determine whether they have in form been properly drawn and negotiated, thus limiting the checks returned by the Auditor to those which represent unauthorized disbursements.

Tracing Items after Payment by the Treasurer.

On this subject Mr. Brown says:

> "It is true that for the sake of economy receipts and payments are entered on the books of the Treasurer's office in totals and that the totals are obtained from adding machine lists of the amounts only, without descriptive entries, so that an item can be traced into the ledgers through the adding machine lists only by its amount."

I understand that under the present system checks received from remitting banks are accompanied by a transcript prepared by the bank on which the checks are listed by symbol number, serial number, and amount.

When the mail is opened the banks' transcripts with accompanying checks are placed in boxes or files designed for this purpose, and the contents of each box is treated as a group and is designated by a letter of the alphabet selectedfor that purpose. These groups are then turned over to what is called the proving section of the Treasurer's office. In order that each check and transcript may thereafter be identified as belonging to that group, the checks and transcripts are then perforated with a machine which cancels the check and shows the date of payment and group letter. The checks are then proved against the transcripts which they accompany, after whichthey are sorted according to the symbol of the disbursing officers. When this has been done the signatures are compared and the checks drawn by each disbursing officer are then run off on an adding machine and the total of all checks of each disbursing officer is charged to his account in the ledger. The total of all disbursing officers' checks must, of course, agree with the total of all transcripts sent in by the bank. The checks are then sent to the Auditor. If the Auditor later discovers an irregularity in a negotiation of the check or if it appears that the check has been drawn for an unauthorized purpose, it is returned to the Treasurer. If the last indorsement is regular the Treasurer can immediately determine what bank sent it in by this indorsement. If the remitting bank has failed to indorse, the Treasurer's office must determine by the perforation in what group the remitting bank's transcript is filed, and must then identify the check by symbol number and amount shown in the transcript of the remitting bank.

As there are more than seven hundred banks making such remittances, this trace involves some labor and this labor is increased if the irregularity is not discovered until some days after payment. If the Federal reserve banks handled these checks each item could be entered in the individual ledger account of the disbursing officer - the Treasurer would receive only twelve instead of seven hundred or more transcripts with checks already assorted according to disbursing officers and the work would unquestionably be simplified.

SECOND. Expenses under Present System.

The memorandum of July 18 was intended merely as an outline of a plan and no attempt was made to consider the details of operation.

It is manifest, however, that if the sorting and handling of a large proportion of the checks now handled by the Treasurer's office can be transferred to the Federal reserve banks the work required of the Treasurer's office will be materially reduced. The added expense to the Federal reserve banks would be offset by an increase in their deposits. These deposits would contribute to the earnings of the Federal reserve banks and would no doubt more than defray the expenses of handling the checks in question. The Government would, therefore, save part of the expense now incurred by the Treasurer's office, and would benefit by the increased earnings of the Federal reserve banks, since all the profits of such banks over and above dividends and expenses are paid to the Government after a reasonable surplus has been created.

In the matter of reduction of expenses in the Treasurer's office, Mr. Brown estimates that it would cost $5,000 a year merely to examine the checks to see that the payee has indorsed. It necessarily follows that it costs several times this amount (a) to prove the transcripts, (b) to sort the checks, (c) to make a visual comparison of the signatures, (d) to run them off a second time on adding machines, and (e) to perforate each check so as to connect it with the bank's transcript.

This expense would in large part be saved.

To determine with any accuracy the amount that could be saved would involve an investigation of the details of the work of the Treasurer's office, but it seems evident that if the Federal reserve banks can absorb a large part of this work without added expense and with a possible profit, a saving could be effected of a considerable amount.

THIRD. Centralization v Decentralization.

Mr. Brown argues at some length that the present system has practically all of the advantages without the disadvantages of a decentralized system.

In support of this argument he points out -

(a) That the majority of the officers who have occasion to consult the accounts or to be consulted with reference to them are located in Washington.

(b) That the administrative officers having supervision over the disbursing officers are located in Washington.

(c) That approximately sixty per cent of all checks are issued at Washington.

(d) That the bulk of credits originate here.

(e) That daily and monthly statements of the condition of the Treasury are prepared here and are taken from controlling accounts kept in Washington.

He suggests that if the accounts were carried elsewhere there would be delay -

(f) In the entry credits to disbursing officers.

(g) In furnishing information regarding balances.

(h) In reporting irregularities.

(i) In filing the majority of notices to stop payment on checks.

(j) The collection of information for the daily and monthly statements.

Considering these suggestions in the order in which they appear:

(a) The accounts of the Treasurer would, of course, continue to be maintained in Washington under the plan proposed in memorandum of July 18. The twelve Federal reserve banks would be substituted as depositories for the 700 or more depository banks referred to by Mr. Brown. They would relieve the Treasurer's office of the detail work of handling checks of many of the disbursing officers and it is believed that the work of the Treasurer's office could be very much simplified.

(b) The heads of departments and bureaus necessarily have supervision over a great many subordinates including disbursing officers located elsewhere than in Washington. The presence in Washington of subordinate officials is not essential to effective supervision.

(c) Mr. Brown estimates that sixty per cent of the Government checks originate at Washington; that fifty per cent of all Government checks are issued by the pension office. It appears, therefore, that other than pension checks only ten per cent of the Government checks are issued by disbursing officers located here.

Under existing statutes pension checks must be drawn against the Treasurer of the United States and it would not be necessary to transfer to Federal reserve banks other accounts against which checks are drawn for purely local disbursements.

(d) While the bulk of credits for disbursing accounts necessarily originate at Washington, since these are transferred pursuant to appropriations made by Congress, there would be little difficulty in opening such credits with the twelve Federal reserve banks.

(e) The daily and monthly statements could no doubt be prepared with equally as great expedition as under the present system if the balances had to be obtained from the twelve Federal reserve banks and the Treasury Department. Assuming that it is necessary to obtain information by telegram as to the actual balance in the Federal reserve banks this can be done at comparatively small cost, - certainly at much less than the cost of compiling this information under existing circumstances. The statements thus prepared would be more accurate than is possible under existing circumstances, as it is assumed that the Treasury Department does not obtain a telegraphic report from the seven hundred or more depository banks as to the balances at the end of each day.

(f) The opening of credits with Federal reserve banks for disbursing officers could be arranged with little if any delay.

(g) Information as to balances to the credit of local disbursing officers could be furnished as at present. Disbursing officers located elsewhere could obtain verification of their accounts from the Federal reserve banks in which their accounts are carried.

(h) The greater scrutiny of items made possible under the new system would expedite rather than retard the report of irregularities.

(i) The stop-payment orders would be filed with the Treasurer or with the Federal reserve bank carrying the account by the disbursing officers. It is manifest that such an order could be placed with the Federal reserve bank of San Francisco by a disbursing officer in that district more promptly than is possible with the Treasury Department.

(j) The collection of information for the daily and monthly statements should not be delayed under the proposed plan, since it would involve the collection and analysis of twelve accounts rather than the more extensive compilations necessary under the present plan.

Mr. Brown also argued that a decentralization of accounts offers no advantages to offset the disadvantages just considered. In support of this argument he suggests:

(a) That the Government checks are likely to remain outstanding if drawn against Federal reserve banks equally as long as under the present system, since the banks receiving them will still desire to use them for exchange purposes, and since they must be acceptable at par by all depository banks.

(b) That the prompt return of checks is now assured by the requirements that the sixty or more depository banks and the Federal reserve banks remit them directly to the Treasurer; that while this requirement is sometimes disregarded it is more or less effective.

It is evident from these suggestions that the clearing house operations of the Federal reserve banks have been overlooked. A member bank receiving a Government check on a Federal reserve bank bank would have every inducement to forward it direct to its Federal reserve bank. The credit thus established could be counted as reserve or used for exchange purposes. Under the present system it is understood that when a bank cashes a Government check, if its authorized balance is thereby reduced, arrangements are made to restore this balance as promptly as possible, and the Treasurer will, upon the request of the bank whose balance is depleted, make a deposit for its account with an approved reserve agent. This is no doubt what Mr. Brown means when he says that Government checks can be used to supplement a bank's reserve.

It is obvious, however, that the most direct method of accomplishing this result would be for the member bank to remit the check to its Federal reserve bank where it could be immediately credited to the member bank's reserve account and charged to the account of the disbursing officer whose name appears thereon as a drawer. It would in this way immediately become available as reserve or for exchange purposes, whereas, under the present system the Treasurer's office has to arrange a transfer of funds or a deposit for the account of the member bank remitting the check.

FOURTH. Contemplated Economies.

Mr. Brown states that the transfer of the accounts to the Federal reserve banks would prevent further important economies in handling the checks which can be effected if the accounts remain in Washington.

The economies contemplated appear to be embodied in a plan by which it will be possible to relieve the Treasurer of the duty of preparing at the end of each month detailed lists of the numbers and amounts of the checks paid for each disbursing officer and instead to permit the Treasurer to turn these checks over to the Auditor daily or weekly with adding machine lists on which the charges against the disbursing officers' accounts were accumulated. It is at once apparent that if this plan is adopted it will be impossible for the disbursing officer to verify his own balance. If neither the checks nor a detailed statement showing the number of the check and the amounts are furnished the disbursing officer, he cannot determine what checks are outstanding and what checks drawn by him have been paid. Mr. Brown states that this improvement has already been applied to the pension account. I am advised, however, that under this plan the pension checks were turned over to the Auditor who was required to prepare and furnish the itemized lists to the disbursing officer, so that this merely shifted the work from the office of Treasurer to that of the Auditor, and that as a modification of this plan an arrangement was made by which the Auditor furnishes a list of the unpaid checks in lieu of a list of checks that have been received and paid. If this modified plan were adopted for all accounts it would, of course, be necessary for every disbursing officer to file a duplicate set of accounts with the Auditor of all checks drawn by him so that the Auditor might determine what checks are outstanding at the end of each month.

I am further advised that under the old subtreasury system each assistant Treasurer furnished on the first of each month a detailed list of checks paid, and that there were fewer outstanding checks under this system than the one now in force, for the obvious reason that checks locally drawn were presented to the subtreasuries and cashed promptly, whereas, under the present system they have to be sent to Washington for payment.

## Collection of Revenues.

In commenting on the suggestion made in memorandum of July 18 on the subject of collection of revenues, Mr. Brown says:

> "Mr. Elliott's suggestion regarding the handling of Government deposits, namely, that they be received by member banks on behalf of the Federal reserve banks, but that the certificates be transmitted daily to Washington, seems to us excellent. It is not clear, how-

ever, how this plan will overcome the objection that Mr. Elliott makes to the present system, namely -

(1) That banks accepting checks for credit in the Government's account necessarily assume a certain risk;

(2) That the Division of Public Moneys keeps a large number of accounts with respect to deposits."

It is true that this plan would not overcome the risk that a bank assumes when it accepts an uncertified check in payment of Government revenues. Under this plan, however, the number of accounts which would be necessary for the Division of Public Moneys to maintain would be reduced from more than 700 to twelve, since the certificates of deposit would be charged against the Federal reserve bank and not the member bank.

Mr. Brown suggests that the accounts in the Division of Public Moneys are probably the so-called journal and register of deposits; that the Bureau of Efficiency deems both unnecessary and has recommended that they should be abolished. That the work of this Division should be limited to checking the totals of certificates of deposit against periodical reports of deposit received from administrative offices. There is evidently a difference of opinion as to the necessity of maintaining this journal and register of deposits. Unless, however, the certificates of deposits received are carefully scrutinized and some detailed record is kept, there would seem to be great danger of making credits to the wrong accounts and the necessity for numerous counter entries. The difficulty of tracing items would undoubtedly be increased if ledger entries are made only from adding machine totals. The number of counter entries that have been made as a result of errors discovered through the use of this journal and register will afford a practical demonstration of its value.

In conclusion, it is submitted that the centralization of Government credits and Government disbursements in the office of the Treasurer at Washington is not consistent with the spirit of the Federal Reserve Act. It was the hope of the framers of that Act that Federal reserve bank exchange would gradually replace to a great extent what is commonly called New York exchange, i. e., to say credit balances carried with New York banks.

The congestion of credits in one city necessarily involves constant transfers of funds from and to that city. New York exchange has become one of the most generally used mediums for the settlement of bank balances and the discharge of individual trade and other obligations. A system under which local bank credits can be used in the discharge of local obligations will eliminate a great deal of the waste incident to the constant transfer of funds and will reduce the volume of items constantly in transit. The clearing operations carried on by the Federal reserve banks are contributing materially to the accomplishment of the desired objects. The Federal Reserve Board is urging member banks to clear through Federal reserve banks, i. e., to adjust their balances and to make their collections through such banks. The use of these banks as fiscal agents of the Government in the collection and disbursement of its revenues should not only prove a benefit to the Government but will also prove a great benefit to the system by facilitating the settlement of balances without the actual transfer of funds and by increasing the earning capacity of the several Federal reserve banks.

It is, therefore, respectfully submitted that the advantages to be derived more than counterbalance any supposed disadvantages.

Respectfully,

M. C. ELLIOTT.
Counsel.

12/15/16

FEDERAL RESERVE BOARD

WASHINGTON



1764

-917b-

November 2, 1916.

Dear Mr. Delano :

I send you, herewith, a memorandum, dated October 16, 1916, prepared by Herbert D. Brown, Chief of the United States Bureau of Efficiency, criticizing Mr. Elliott's memorandum dated July 18, 1916, as to the present methods of accounting between the Treasury and depositaries.

Will you kindly read these over. I would suggest that it might be well to make copies of these and send a copy to each Federal Reserve Bank so that they could make a study of the matter and submit suggestions to us. If you approve of this I will ask Mr. Williams for his approval and then we can report it to the Board.

Very truly yours,

C. S. HAMLIN

Hon. F. A. Delano,
Federal Reserve Board.

Enclosures.

October 16, 1916.

Hon. Charles S. Hamlin,
Federal Reserve Board,
Washington, D. C.

Dear Mr. Hamlin :

It recently came to my attention that Mr. Elliott, counsel for the Federal Reserve Board, had submitted a memorandum in which he urged that the revenues of the Government be deposited in Federal reserve banks through their member banks and that the accounts of Government disbursing officers be transferred to the twelve Federal reserve banks under a decentralized system substantially similar to the old subtreasury system. I was also told that Mr. Elliott had supported his proposal with severe criticisms of the present method of keeping disbursing officers' accounts in the Treasurer's office.

As the Bureau of Efficiency was largely responsible for the establishment of the present system in the Treasurer's office, I was naturally interested in the matter, and asked your Secretary for a copy of Mr. Elliott's memorandum in order that I might have the opportunity to judge as to the justice of his criticisms.

An examination of the memorandum revealed several inaccuracies in his description of the Treasurer's system. Moreover, some of the advantages claimed for the transfer of the disbursing officers' accounts to the Federal reserve banks seem to be questionable, and certain serious disadvantages of the transfer have been overlooked.

In justice to the Bureasu of Efficiency I feel that I should point out the errors in Mr. Elliott's statements regarding the present system. It also seems desirable that the Federal Reserve Board should be fully advised as to the disadvantages of transferring the disbursing officers' accounts away from Washington, and I am therefore taking the liberty of pointing out some of those disadvantages. I trust that the Board will not regard this as presumptuous.

In a word, we believe that every advantage of the system proposed by Mr. Elliott, and many other advantages, can be obtained by a system under which the disbursing officers' accounts will be kept at Washington. Of Mr. Elliott's criticisms against the routine procedure in the Treasurer's office, none seem important except the statements that the drawer's signature and the last indorsement are not inspected, and that it is difficult to stop payment and to trace items after payment. As explained below, these statements are inaccurate.

While Mr. Elliott'criticises the present system on the ground of expense, he offers no specific suggestions as to how the expense could be reduced, and practically every suggestion that he makes regarding methods would increase the expense without substantial benefit.

The present system in the Treasurer's office was devised after an examination of the systems of several of the largest and most efficient banks in New York. We believe that it will compare favorably in economy and efficiency with the systems of even the most efficient banks, and we respectfully suggest that the Board obtain comparative statistics as to the cost of handling checks in the Treasurer's office and in the Federal reserve banks before adopting the view that the cost of the work in the Treasurer's office is unduly high.

Before the present system was established we also, at your request, gave careful consideration to the question whether the disbursing officers' accounts should be centralized in Washington or distributed among the subtreasuries or Federal reserve banks. At that time we expressed our judgment that the centralization of the disbursing officers' accounts at Washington had important advantages without any serious disadvantages, whether the work were directed and the expense borne by the United States or by the Federal reserve banks.

This belief was based on the fact that the majority of the officers who have occasion to consult the accounts, or to be consulted with respect to them, are located here in Washington. Practically all of the administrative officers who have supervision over the disbursing officer's work are stationed in Washington. About 60 per cent of all the checks are issued in Washington. The bulk of the credits originate in Washington through action taken by the Secretary of the Treasury on the request of the heads of the executive departments. The controlling accounts from which are drawn the daily and monthly statements of the condition of the Treasury are kept in Washington. Keeping the disbursing officers' accounts elsewhere would delay the entry of credits to disbursing officers, the furnishing of information regarding balances on requests by administrative and disbursing officers, the reporting of irregularities to administrative officers, the filing of the majority of the notices to stop payment, and the gathering of information for the daily and monthly statements of the condition of the Treasury. It would make necessary the use of the telegraph in hundreds of cases where telephone or messengers are now used.

The decentralization of the accounts seems to have no advantage to offset the foregoing disadvantages. The chief objection to centralization that is urged by Mr. Elliott, namely, that the checks are likely to remain outstanding a long time because they can be conveniently used by banks to establish credit and settle balances in other cities, would apply with equal force to any system under which Government checks could be cashed at par in any part of the United States. If the system urged by Mr. Elliott does not meet this requirement it would certainly be unsatisfactory. If it does meet this requirement it would not prevent the checks from being used in establishing credit and settling balances between different cities and would not expedite their return to the office on which they were drawn.

At present the reasonably prompt return of the checks to Washington is assured by the requirement that each of the 60, or more depositary banks, including the Federal reserve banks, must remit directly to the Treasurer all Government checks received by them. While this requirement is sometimes disregarded, it is on the whole effective, and the checks apparently do not stay out much, if any, longer than under the old subtreasury system.

It is true that under the present system many Government checks are handled in Federal reserve banks and again handled in the Treasurer's office, and it would seem that a saving could be effected by allowing such checks to be finally paid and charged to the drawers' accounts in the Federal reserve banks. In fact, however, this would not be the most satisfactory method of eliminating the duplication, for three reasons :

(1) It would not be effective unless many of the disbursing officers maintained several accounts and drew every check on the Federal reserve bank in whose district the payee resided. This would impose considerable additional labor and expense on disbursing officers, and would necessitate their holding, in the aggregate, larger balances.

(2) The same result can be obtained even more effectively by retaining the accounts at Washington and having the member banks send Government checks directly to Washington for credit in their reserve accounts at their Federal reserve banks.

(3) The transfer of the accounts to the Federal reserve banks would prevent further important economies in the handling of the checks that can be effected if the accounts remain in Washington.

These points are discussed below in greater detail:

(1) Mr. Elliott suggests that each disbursing officer keep his account in the Federal reserve bank in whose district he is stationed. Under this plan it is probable that as many Government checks would be handled by two Federal reserve banks as are now handled by one Federal reserve bank and the Treasurer's office. Take, for example, the 60 per cent of all disbursing officers' checks that are drawn in Washington. These checks are payable in all parts of the United States. Only a comparatively small number are paid in the Richmond district. If they were all drawn on the Richmond bank, a large majority would be paid in other Federal reserve districts and sent through the reserve banks of those districts to the Richmond bank, just as they are now sent to the Treasurer. In fact, a large percentage of them would probably be doubly handled in this way, for under the present plan many of the checks do not pass through the Federal reserve banks, but come directly to the Treasurer from member banks, whereas under

the proposed plan, as we understand it, all exchanges between districts would be made through the Federal reserve banks.

At Richmond the accounts would be located inconveniently for the drawers, the administrative officers, and the Treasury officials. They would be convenient to no one.

If, on the other hand, an effort were made to draw all checks on the Federal reserve banks in whose districts the payees resided, it would be necessary for many disbursing officers to have a number of accounts where they now maintain one. As can be easily seen, this would add to the labor of granting credits, drawing checks, looking up checks on subsequent inquiries (especially if the payee's address should not be known), and assembling checks with vouchers in the auditors' offices. Under such a plan none of the accounts maintained by Washington disbursing officers would be convenient for reference by any Government officer.

(2) Turning to the second point, it would be quite simple to apply to check payments substantially the same plan that Mr. Elliott indorses for Government deposits - that is, to permit member banks to pay checks on behalf of their Federal reserve banks, but require them to remit the paid checks directly to Washington. Under this plan the member banks by paying Government checks and sending them to Washington, could replenish their reserve deposits. This

would give them a strong incentive to retire Government checks, rather than send them to some other bank. In order that the credits might be entered promptly on the books of the Federal reserve banks, duplicate transit letters should be sent to those banks. The totals of these letters should be credited to the member banks and charged to the Government promptly, subject, however, to verification from Washington.

This plan would go as far as possible in eliminating duplication in the handling of Government checks, and at the same time would retain the accounts at Washington and give the Federal reserve banks the advantage of all the Government deposits that are maintained for the payment of Government checks.

(3) Under the present plan we believe that it will be possible to relieve the Treasurer of the duty of preparing at the end of each month detailed lists of the numbers and amounts of the checks paid for each disbursing officer, and instead permit him to turn the checks over to the auditor daily or weekly with the adding machine lists on which the charges against the disbursing officers' accounts were accumulated. This plan, which would hardly be practicable if the disbursing officers' accounts were kept away from Washington, would also facilitate a prompt audit of paid vouchers, which we believe will become possible in the near future. This improvement has already been applied to the largest account - that of the pension disbursing officer, who issues nearly one-half of all Government checks. If the pension account were distributed among the reserve banks or transferred to Richmond, it would be necessary to resume

the practice of listing the paid checks, at large expense, and also to delay the audit at least a month.

The argument urged by Mr. Elliott in favor of the proposed system, that it would make the funds of the United States available in the parts of the country where they are most needed and that it would make the deposits of revenues available for the payment of checks without the physical transfer of money, is equally applicable to the present system, which was adopted for the purpose of securing those very advantages. Depositary banks are now selected with regard to convenience in depositing Government revenues and paying Government checks, and the balances in the several depositaries are determined by the need for Government funds in the locality. Each depositary pays the Government checks presented to it out of the Government revenues deposited with it, and settles with the most convenient subtreasury or depositary bank for the net excess or deficiency of receipts only. Usually the settlement is made by check or draft. The points to which the transfers are made are subject to the control of the Treasury Department, which has a complete record of the daily balances in every bank.

Mr. Elliott's suggestion regarding the handling of Government deposits - namely, that they be received by member banks on behalf of the Federal reserve banks, but that the certificates be transmitted daily to Washington - seems to us excellent. It is not clear, however, how this plan would overcome the objections that Mr. Elliott makes to the present system, namely, (1) that banks accepting checks for credit in the Government's account necessarily assume a certain risk, and (2) that the Division of Public Moneys keeps a large number of accounts with respect to deposits.

(1) The risk in accepting checks for credit in the Government's account would seem to be the same whether the receiving bank takes the deposits on its own behalf or on behalf of its Federal reserve bank.

(2) It is presumed that in speaking of the accounts in the Division of Public Moneys, Mr. Elliott refers to the so-called covering journal and register of deposits. On January 10, 1916, we pointed out, in a memorandum to the Assistant Secretary of the Treasury, that this journal and register are wholly unnecessary under the present system and that a saving of more than $20,000 a year can be effected by discontinuing these records and limiting the work of the Division of Public Moneys to that of checking the totals of certificates of deposit against periodic reports of deposits received from administrative offices.

In order that the deposits may be properly credited we believe that it will be necessary for the Treasury to get such reports of deposits from administrative offices rather than depend on the accounts current of the Federal reserve banks, as Mr. Elliott apparently intends to suggest; for the Federal reserve banks' information as to the source of the money deposited would not be reliable enough to be depended on as the basis for final entries in the Treasury books.

Turning to Mr. Elliott's criticisms of the routine procedure in the Treasurer's office we find them to be (1) that the checks are not properly scrutinized before payment; and (2) that stoppage of payment on checks and tracing of items after payment is difficult.

(1) Mr. Elliott states that the Treasurer's office does not give proper scrutiny to (a) the drawer's signature, (b) the last indorsement, (c) the original indorsement, (d) intermediate indorsements in order, and (e) the object for which drawn.

(a) In fact, the method of verifying the drawer's signature in the Treasurer's office is more effective than the usual method in banks. The checks are sorted by account numbers behind guide cards bearing the autograph signatures of the disbursing officers and of any deputies authorized to sign in their places, and the correctness of the sorting is verified by a careful visual comparison of the signatures on the checks with the autograph signatures on the guides. Under this system, I understand that no forgery or unauthorized signature has slipped through that could have been detected except by a handwriting expert after careful study.

(b) The last indorsements on the checks are not examined in the Treasurer's office but the checks are perforated in such a manner as to connect them unfailingly with the banks' transcripts of account on which they are listed. I understand that in two years of operation, during which nearly 20,000,000 checks have been handled, there has not been a case of inability to trace a check back to the last indorser, although thousands of checks have been returned to the banks transmitting them.

(c) The original indorsement is not examined because in our judgment and in that of the Treasurer such an examination would merely waste the Government's money. The most that the examination could show is that the check was indorsed in the same name in which it was drawn. If a fraud had been attempted the check would almost infallibly be so indorsed, while if the right person had received payment, but had indorsed the check erroneously, the detection of that fact in the Treasurer's office would merely lead to fruitless labor. We understand that in the two years during which the present system has been in operation there has been no loss that an inspection of the original indorsement would have prevented and no error that such an inspection of the original indorsement would have prevented and no error that such an inspection would have detected. On the other hand it is estimated by the Treasurer's office that in the two years the work of inspection would have cost not less than $10,000.

If an examination of the original indorsement is desirable it could be made much more effectively by the Auditor than by the Treasurer, for the Auditor could compare the indorsement with the payee's signature on the voucher and might thus detect a forgery, while the Treasurer could detect nothing but a misspelling or a failure of the payee to indorse.

If anything should be wrong with the indorsement of a check all the banks indorsing the check would be liable, since all of them have guaranteed prior indorsements; and the Treasurer is in a position to send the check back to the last indorser, on whom the burden of holding the prior indorsers would rest.

(d) The Treasurer does not inspect intermediate indorsements nor see that they are in order. While we are not familiar with the methods of all the large banks in the country, we doubt if any of them puts itself to such a needless expense.

(e) The statements on the checks as to the object for which they are drawn are also not verified. This does not concern the Treasurer any more than the object for which personal checks are drawn concerns the bank that pays them. If the Treasurer should examine these statements he would have no means of verifying them, since he does not have the vouchers. Even if he should detect that the object for which drawn was erroneously stated, there would be nothing that he could do about it with advantage. The purpose for which a check was drawn is a question for the consideration of the Auditor, who has the voucher that was paid thereby.

(2) We are at a loss to know the basis for Mr. Elliott's statement that it is unusually difficult to stop payment on checks under the present system in the Treasurer's office. Every day, after the checks chargeable in each disbursing officer's account have been listed to obtain the amount to be charged to his account, the checks are sorted according to the thousands digit of the serial number, and a search is made in each thousand for checks on which stop orders have been issued, as shown by a list prepared for the pur-

pose. I understand that very few checks escape this search - probably not more than would escape the bookkeeper in a bank in which checks were posted individually to the account of the drawer.

During the two years that the present system has been in operation in the Treasurer's office I understand that no serious difficulty has arisen in tracing items after payment. It is true that, for the sake of economy, receipts and payments are entered on the books of the Treasurer's office in totals, and that the totals are obtained from adding machine lists of the amounts only, without descriptive entries; so that an item can be traced into the ledgers through the adding machine lists only by its amount. However, two descriptive entries of each item are retained in the Treasurer's office or in some other office of the Treasury Department where they are easily available: (a) The entry on the transcript of the bank that received the deposit or paid the check, and (b) The deposit slip or check itself, which is filed according to the account to which it was posted. When a deposit slip or check leaves the Treasury Building it is recorded in detail so that it can be easily traced.

Very respectfully,

HERBERT D. BROWN
Chief, Bureau of Efficiency.

12/15/16