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GAO

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General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-261436

June 5, 1995

The Honorable Ricki Helfer
Chairman, Board of Directors
Federal Deposit Insurance Corporation

Dear Madam Chairman:

In March 1995, we issued our opinions on the calendar year 1994 financial statements of the Bank Insurance Fund (BIF), Savings Association Insurance Fund (SAIF), and FSLIC Resolution Fund (FRF). We also issued our opinion on the Federal Deposit Insurance Corporation (FDIC) management's assertions regarding its system of internal controls at December 31, 1994, and reported on FDIC's compliance with significant provisions of selected laws and regulations for the three funds for the year ended December 31, 1994 (GAO/AIMD-95-102, March 31, 1995).

In conducting our 1994 audit, we found that FDIC made progress in addressing some of the accounting procedure and internal control matters identified in our management letter from our 1993 audit (GAO/AIMD-94-160ML, August 29, 1994). The purpose of this letter is to report to you matters identified during our 1994 audit regarding accounting procedures and internal controls which could be improved. Some of these problems were first reported as a result of our 1993 audit. These matters are not considered material in relation to the financial statements of the three funds, however, we believe they warrant management's attention. We have grouped these matters into the following broad issues: (1) receipts and disbursements (enclosure I), (2) reconciliations (enclosure II), (3) loan loss reserve system (enclosure III), (4) electronic data processing (enclosure IV), (5) policies and procedures (enclosure V), and (6) other (enclosure VI). The enclosures discuss these matters and include our suggestions for improvement. Also, one additional matter concerning data processing security is being communicated to you in separate correspondence because of its sensitive nature.

We conducted our audits pursuant to the provisions of section 17(d) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1827(d)), and in accordance with generally accepted government auditing standards.

We would appreciate receiving your comments and a description of the corrective actions FDIC plans to take to address these matters within 30 days from the date of this letter. We acknowledge the cooperation and assistance provided by FDIC officials and staff during our 1994 audits. If you have any questions or need assistance in addressing these matters, please contact me at (202) 512-9406 or Steven J. Sebastian, Assistant Director, at (202) 512-9521.

Sincerely yours,

Robert W. Gramling

Robert W. Gramling
Director, Corporate Financial
Audits

Enclosures

cc: Mr. William A. Longbrake
Chief Financial Officer
and Deputy for Financial Policy
Federal Deposit Insurance Corporation

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Chief Operating Officer and Deputy
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Mr. Steven A. Seelig
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Federal Deposit Insurance Corporation

The Honorable James A. Renick
Inspector General
Federal Deposit Insurance Corporation

Mr. Russell Cherry
Division of Finance
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RECEIPTS AND DISBURSEMENT ISSUES

ACCESS TO ACCOUNTS PAYABLE SYSTEM WAS NOT ADEQUATELY RESTRICTED

A standard control practice in an automated data processing control environment is to periodically ensure that personnel who perform certain functions continue to require the level of access authorized. Thus, sound internal control procedures would require that only authorized personnel who need access to FDIC's automated check printing function be periodically confirmed as needing such access. As such, FDIC's Regional Accounting Manual (RAM) requires that accounts payable staff use personal identification numbers (PIN) to access the automated check printing function to prevent unauthorized printing of checks. However, the RAM does not require that the list of authorized users be periodically updated.

We found that one field office had not established procedures to periodically update its accounts payable system user list. Consequently, this office did not delete access to the automated check printing function for those individuals who no longer had responsibility for printing checks. Subsequent to our visit, this office implemented procedures to update its computer software systems as part of an employee termination package. However, this does not address those employees who are still with the agency but no longer have responsibility for the check printing function. In the absence of such a control, the potential exists for unauthorized individuals to access the check printing function.

We suggest that FDIC modify the RAM to require all field offices to periodically update the authorized accounts payable user list to ensure that only authorized personnel can access critical accounts payable functions.

DISBURSEMENT ACTIVITY AT ONE FIELD OFFICE WAS NOT ADEQUATELY REVIEWED

FDIC's RAM requires that disbursements be properly authorized, supported by adequate documentation, and recorded in the proper general ledger account. To accomplish this, the RAM requires that Accounts Payable Unit staff initial the Cash Disbursements Journal to document that checks have been reviewed and the correct account has been charged. Further, the RAM requires the Accounts Payable Unit staff to review invoices and supporting documentation to ensure mathematical accuracy and to avoid duplicate payments.

We found that inadequate review procedures existed at one FDIC field office. This led to errors going undetected by the Accounts Payable Unit staff. For example, we found (1) expenses recorded in an incorrect account, (2) a disbursement that did not agree with the invoiced amount, (3) a disbursement that was approved even though the vendor's invoice was not adequately supported, and (4) a past due amount that was paid without approval from the originator of the check request. Also, we found that the field office's Accounts Payable Unit staff failed to initial the Cash Disbursements Journal to indicate that checks disbursed had been adequately reviewed.

We suggest that FDIC work with the applicable field office to ensure compliance with RAM procedures for (1) reviewing vendor invoices for mathematical accuracy and the propriety of the disbursement and (2) performing and documenting a daily review of the Cash Disbursements Journal to ensure that expenses are recorded in the appropriate general ledger account.

DISBURSEMENT CONTROLS AT ONE SERVICER ARE INADEQUATE

The Contractor Oversight and Monitoring Branch (COMB) is responsible for monitoring the activities of FDIC's contracted asset servicers to ensure that, among other things, reported disbursements are valid and internal control systems are adequate. COMB requires that the servicers' internal control systems segregate disbursement duties to minimize the risk of waste, loss, unauthorized use, and misappropriation of assets. COMB performs an annual review at each servicer to assess the adequacy of their internal controls. In addition, FDIC's Contractor's Operating Manual requires that all disbursements be paid from original invoices or proper receipts.

We found that one contractor did not adequately segregate key disbursement duties. Specifically, one servicer employee authorized to approve disbursements also performed bank account reconciliations, maintained custody of blank checks, recorded transactions on the accounting system, and prepared monthly reports for FDIC. Such a lack of segregation of duties increases the risk that fraudulent payments could be made without detection. Also, we found two disbursements approved based only on oral communication. Disbursements made based on oral communication expose FDIC to the risk of paying incorrect or inappropriate amounts. For example, one of these expenses that FDIC had reimbursed was not eligible for reimbursement because it was not allowed under the terms of the servicing contract. In 1993, COMB's site visitation also found similar documentation deficiencies.

These conditions occurred because a key employee took extended leave resulting in too few employees for adequate segregation of duties and because the servicer did not enforce FDIC's disbursement documentation requirements.

We suggest that FDIC work with the applicable contract servicer to ensure that (1) proper segregation of duties is maintained and (2) the contractor's operating procedures for approving disbursements are followed.

INADEQUATE CONTROLS EXIST OVER TRAVEL ACCOUNTING AND EXAMINATION PROCEDURES

The Comptroller General's Standards for Internal Controls in the Federal Government specifies that transactions are to be correctly and promptly recorded in order for pertinent information to maintain its relevance and value to management in controlling operations and making decisions. These standards also specify that audit findings should be promptly resolved.

We found that FDIC did not enforce its control procedures designed to ensure that (1) the proper fund and/or Financial Institution Number (FIN) was charged for travel expenses and (2) duplicate payments were detected. We also found that travel vouchers were not approved and audited promptly.

Incorrect fund and/or FIN codes charged on the travel voucher and entered into the Travel Management System could result in over- or understating recorded travel and other expenses for each of the funds and the receiverships. In addition, not adhering to control procedures could result in duplicate payments not being detected. Also, the lack of timely approval and audit of travel vouchers increase the likelihood that such errors will not be detected and corrected.

We suggest that FDIC ensure that travel vouchers are (1) promptly approved and audited and (2) not approved until all information on the voucher is completed accurately. Also, we suggest that FDIC ensure that voucher auditors review the fund and/or FIN codes on each travel voucher to ensure that the accounting data are accurate and agree with the fund and/or FIN specified on the Travel Authorization. Explanations should be obtained for inconsistencies and audit exceptions should be recorded.

RECEIPTS WERE NOT
PROPERLY CONTROLLED
OR PROMPTLY DEPOSITED

FDIC's RAM requires that personnel reconcile control totals for daily cash receipts to the cash receipts processed through the Cashier's System. The RAM also requires that all checks received before the depository deadline be deposited on the day of receipt and checks received after the deadline be deposited the next day.

However, during our 1994 and 1993 audits, we found that cash receipt controls were not implemented effectively. Specifically, we found that cash receipts were not properly reconciled or promptly deposited. At three FDIC field offices, receipt control totals were not reconciled to checks processed in the Cashier's System. Also, at two of these three locations, checks were deposited 2 to 4 days after receipt. Staff shortages may have contributed to not following deposit requirements, but timely deposit of receipts was not emphasized.

These weaknesses increase the risk that receipts are not properly processed and accurately recorded on the Financial Information System (FIS). In addition, failure to promptly deposit checks increases the risk of loss or misappropriation and reduces FDIC's ability to maximize its potential interest income on collections.

We suggest that FDIC emphasize the importance of adhering to the RAM requirements to reconcile daily receipts to control totals and deposit checks within the specified time frames, and to periodically check compliance with the RAM.

RECONCILIATION ISSUES

RECONCILIATIONS OF SERVICED ASSETS WERE NOT PROPERLY PERFORMED

The servicing agreements between FDIC and the contracted asset servicers require servicers to maintain a separate general ledger that reflects all serviced assets and related liabilities and to report servicing activity to FDIC each month. Also, the servicers reconcile the general ledger balances to detailed subsidiary records. To maintain the integrity of FDIC's Financial Information System (FIS), the reported servicer balances are reconciled to FIS each month. To ensure that misclassifications are detected in these reconciliation processes, both the servicers' general ledger and subsidiary records should capture transaction data by asset type.

For two of the contracted servicers visited during our 1994 audits, we found that serviced asset balances were reconciled by total assets instead of by asset type. One servicer reconciled the total assets in its general ledger to the total assets in its subsidiary records because the general ledger did not classify assets by asset type. While the FIS balances were reconciled by asset type to another servicer-prepared report, this report was not reconciled back to accounting records to ensure its accuracy. The other servicer reconciled the aggregate serviced assets balance to FDIC's FIS by total assets instead of by asset types. By not reconciling serviced asset balances by asset type, FDIC has no assurance that FIS is free of misclassifications. It also increases the risk that errors may not be detected and corrected promptly.

We suggest that FDIC require servicers to reconcile their general ledger to subsidiary records by asset type. In addition, we suggest that FDIC reconcile FIS to reported servicer balances by asset type.

LIABILITY BALANCES WERE NOT SUPPORTED BY DOCUMENTATION AND RECONCILING DIFFERENCES WERE NOT RESOLVED PROMPTLY

FDIC's RAM requires that asset and liability account balances on FIS be supported by sufficient documentation. Also, the RAM requires monthly reconciliations of FIS to subsidiary records and prompt resolution of reconciling items.

We found that items on FIS were not always recorded in subsidiary records and were not always supported by documentation. For example, at one FDIC field office, $421 million in notes payable on FIS were not recorded in the subsidiary ledger and not supported by documentation. In addition, reconciling differences between FIS and subsidiary records were not resolved promptly for mortgages and notes payable. Specifically, at another FDIC field office, notes payable balances were either recorded incorrectly or not recorded on the subsidiary ledger. While these items were identified during the monthly reconciliation process, FDIC did not promptly resolve them. One such delay caused an eight month lag in recording $28 million of collections on the underlying assets of a note payable.

These notes payable were not properly recorded on FIS because they had been transferred between FDIC field offices without adequate supporting documentation. The field offices receiving the notes payable were required to perform extensive and time-consuming research to validate the notes before they could be recorded in the subsidiary records. Transferred assets and liabilities not adequately and promptly verified could misstate the financial statements of the three funds administered by FDIC.

We suggest that FDIC enforce its policy requiring documentation to support FIS balances and prompt resolution of reconciling items. We also suggest that FDIC ensure that all assets and liabilities transferred between FDIC offices are supported and promptly recorded on FIS and subsidiary records.

LIABILITY AND DIVIDEND SUBSIDIARY SYSTEM IS NOT BEING USED TO RECONCILE CLAIMS AND DIVIDENDS

The automated Liability and Dividend System (LDS) functions as the subsidiary record for receivership claims and dividends. The RAM requires the Financial Services Unit to maintain and reconcile LDS to the claims and dividend balances on FIS. The subsidiary records should have sufficient detail to serve as an independent record to verify the accuracy of FIS balances.

We found that two offices were not reconciling the corporate claims and dividend balances on LDS to FIS. Also, while the other six offices we visited were reconciling LDS to FIS by total claim and dividend balances, they were unable to verify the accuracy of totals by liability types. This is because the FIS claims and dividend balances are stratified by several liability types, while LDS is programmed to stratify claim and dividend balances only by corporate and receivership liabilities. Consequently, FIS claim and dividend liability types could not be properly reconciled to the subsidiary records and thus could be misclassified.

We suggest that FDIC (1) reinforce the requirement for offices to reconcile claims and dividends on LDS to FIS in accordance with the RAM and (2) reprogram LDS to provide sufficient detail to serve as an independent verification of the claim and dividend balances by liability type.

RECONCILIATIONS OF PAYROLL AND TRAVEL EXPENSES NOT DONE REGULARLY

Standard internal control procedures require periodic comparisons of general ledger control accounts and subsidiary records. These comparisons, or reconciliations, help ensure that errors, omissions, or irregularities are identified and corrected promptly.

During our 1994 audits, we found that data from the Biweekly Time and Attendance System (BTA) and Travel Management System (TMS) are not routinely reconciled to the corresponding payroll and travel expense account balances in FIS. Management has not sufficiently emphasized the need to regularly reconcile these subsidiary systems to the FIS/general ledger as a necessary internal control technique.

Had periodic reconciliations been performed, FDIC would have identified an $11.9 million difference between payroll data on the BTA system and the payroll expense balances on FIS and a $480,000 difference between travel data on TMS and the travel expense balances on FIS. The amounts involved were not material to the financial statements of the three funds. However, without regular reconciliations, such discrepancies could occur again and not be promptly identified and corrected.

We suggest that FDIC ensure that the BTA and TMS systems are reconciled to the payroll and travel expense accounts on a quarterly basis and that reconciling differences are promptly resolved. These reconciliations should be properly documented, permitting complete review of the procedures followed.

LOAN LOSS RESERVE SYSTEM ISSUES

DEFICIENT PROCEDURES RESULTED IN INSUFFICIENT REVIEWS AND UNRESOLVED ANOMALIES

To ensure that the allowance for losses on bank and thrift resolutions and FDIC's investment in corporate-owned assets is accurately calculated, the Loan Loss Reserve (LLR) system produces anomaly reports identifying financial institutions with a loan loss reserve outside expected parameters. FDIC's Loan Loss Reserve Processing Procedures require the LLR operating accountant to research the cause of all anomalies, and, if necessary, refer the anomaly to an appropriate third party for review and resolution.

Our review of this critical control during 1994 revealed that FDIC did not adequately resolve identified anomalies. For example, the LLR system identifies as one anomaly financial institutions which have a negative allowance. For this anomaly, FDIC attributed the negative allowance to debits in liability accounts without performing the necessary research to ensure that such debits were appropriate, and concluded that the anomalies were resolved. Also, FDIC was not able to provide us with documentation to support its claim that certain anomalies were referred to a third party for review when appropriate.

We believe that these conditions are due to the fact that FDIC's LLR procedures do not specify what constitutes an adequate review or disposition. In addition, these procedures use subjective terms such as "small," "large," and "material" without adequately defining them.

Of the BIF and FRF anomalies reviewed, 97 out of 116, or 84 percent were not sufficiently reviewed or adequately resolved. Not adequately resolving identified anomalies may result in misstatements on BIF's, FRF's, or SAIF's financial statements.

We suggest that FDIC (1) establish specific LLR operating procedures for review and resolution of all anomalies identified during the LLR process, (2) define subjective terms to ensure that procedures are consistently applied, and (3) require that anomalies referred to third parties for review are adequately documented and that the third party's findings related to the anomaly are also documented.

LLR SYSTEM DEFICIENCY AND INPUT ERRORS RESULTED IN UNPROCESSED LOAN LOSS RESERVE ADJUSTMENTS

The LLR system electronically accumulates estimated recoveries from the management and disposition of assets in liquidation by extracting data from FIS and the Liquidation Asset Management Information System (LAMIS). The system automatically calculates an allowance for loss on the outstanding balances of subrogated claims and investment in corporate-owned assets by receivership for each fund. To correct FIS and LAMIS data errors, FDIC's Loan Loss Reserve Processing Procedures require the operating accountant to make adjustments through use of an adjustment table.

We found that some adjustment table corrections were entered incorrectly. For example, the LLR operating accountant entered two separate adjustments for the same financial institution number and asset type and erroneously assumed that the LLR system would add matching financial institution numbers and asset type adjustments together and process the sum of the two adjustments. Instead, the LLR system only processed one of the two adjustments. We also found that certain corrections, though properly entered, were not processed by the LLR system. Specifically, we found that an LLR system deficiency resulted in professional claims adjustments less than or equal to zero not being processed. These errors and deficiencies resulted in a net overstatement of BIF's allowance for loss of $0.6 million for BIF and a net understatement of FRF's allowance of $3.9 million. While these weaknesses did not result in a material misstatement to the 1994 financial statements of the three funds administered by FDIC, future misstatements may become significant if FDIC management does not correct these weaknesses.

We suggest that FDIC correct the LLR system deficiency to prevent future processing errors. Also, in order to ensure that all table adjustments are input and processed correctly, we suggest that FDIC establish a procedure to ensure that all processed table adjustments are traced from their source to the financial institution's final Bank Report.[1] In order to prevent input or key-punch errors which may have been entered in the adjustment

[1]The final Bank Report details the calculation of the allowance for loss by receivership and supports the adjustment to each receivership's allowance for loss. The aggregate of all receiverships' allowances, by fund, results in the allowance for loss from resolution activities and investment in corporate-owned assets reported on the three funds' financial statements.

table, we suggest that FDIC trace from the source of the adjustment and not the adjustment table.

EDP ISSUES

FDIC'S CHANGE MANAGEMENT POLICY LACKS IMPLEMENTATION AND STANDARDIZATION

Management of program changes to FDIC's computerized information systems is critical for supporting data security and integrity. A centralized change control function allows an entity to enforce corporate-wide standards benefiting all program applications and users.

In August 1993, FDIC issued an interim change management policy and established a change management committee to establish a corporate-wide change management process and to be the focal point for approving all proposed changes. However, at the completion of our 1994 audit in March 1995, FDIC, through the Division of Information Resources Management (DIRM), had yet to finalize the change management policy.

The change management policy, though still in draft, sets forth certain guidelines for which adherence is expected. We noted during our audits, however, that certain policy provisions designed to provide better standardization are not being implemented. For example, certain functional units are performing procedures unique to their own areas. Although certain changes are entered into the Change Control Application System (CCAS), all parties are not fully utilizing CCAS throughout the entire change process. For example, several database units are using manual forms to specify program modifications instead of utilizing the automated capabilities provided by CCAS as specified in the change management policy. There are no indications that reliance placed on manual processes would be reduced and substantially eliminated. We also noted in our review that formal policies and procedures do not exist for emergency changes made and implemented during nonbusiness hours.

If these conditions remain uncorrected, there is a risk that application integrity may not be maintained. Changes may not be properly analyzed and approved if CCAS does not serve as the repository for all change information from the initial request to implementation. Also, if formal guidelines for emergency modifications are not in place, appropriate personnel may not be notified and emergency changes may not be properly tested.

We suggest that DIRM finalize the corporatewide change management policy, incorporating procedures for emergency changes, and enforce this policy.

FDIC'S DISASTER RECOVERY PLAN NEEDS ENHANCEMENT

FDIC has a formal disaster recovery plan for its computerized information systems. This plan has a designated backup center off-site to assist in the restoration of critical processing in the event of a disruption to FDIC's computer center located in Arlington, Virginia. During our 1993 audit, we noted that the plan did not identify specific critical applications to be recovered in the event of a disaster or the order in which applications are to be restored. This condition also existed during our 1994 audit.

DIRM management has stated that identification of critical applications or the order in which they are restored was not necessary because they expect to recover all production applications shortly after an emergency. However, we found that this is technically impossible since the off-site data center does not provide all the processing and telecommunications capacity needed. In addition, we also noted that FDIC does not conduct unannounced disaster recovery tests.

We believe that a preplanned disaster recovery test does not provide the full benefits of unannounced testing. If a service disruption occurs, users must know in advance which applications will be available for use and the restoration period for these applications. A disruption of computer services for any appreciable period would have an unacceptable impact on many vital activities and, ultimately, FDIC's mission.

We suggest that FDIC perform an analysis to identify the critical applications and their processing and telecommunications capacity requirements and to develop procedures for team members to follow to restore these applications. Once these fundamental aspects of the recovery plan are underway, we suggest that DIRM perform unannounced disaster recovery tests in a realistic simulation mode.

FDIC SHOULD RESTRICT CERTAIN SECURITY PRIVILEGES

An essential component of the separation of responsibilities within an organization is a limit on the information available to users. Information is generally made available on a need-to-know basis.

In our 1993 audit, we noted excessive use of certain information system security privileges. For example, as many as 18 users had the READALL privilege to FDIC's computerized information systems. This is a powerful privilege, allowing users the ability to access and review the entire database and program directory. While these users may require limited access to review selected files such as payroll and the general ledger, individuals should not have the complete READALL privilege.

In response to our 1993 audit, DIRM notified the organization responsible for these 18 individuals of the concerns we raised and received a written response stating that the privilege would be removed for five of these individuals. However, as of the end of our 1994 audit, the responsible organization had not yet indicated for which five individuals the READALL privilege would be removed. In addition, our 1994 review of READALL access revealed that many of the 18 individuals had not used the READALL privilege, and that those few who had only needed access to a select number of files.

We suggest that the system-wide READALL privilege be restricted and that only select personnel who have a valid need be provided READ access to specific information as required.

POLICY AND PROCEDURE ISSUES

ADJUSTMENT TRANSACTIONS WERE NOT RECORDED

To establish an effective internal control environment, management should establish policies and procedures that require complete and accurate recording of transactions and related adjustments. Such internal control procedures ensure that reliable financial data are maintained for internal decision-making, performance measurement, and external reporting.

During our 1994 audit, we found that FDIC did not ensure that all known transactions and related adjustments were properly recorded in FDIC's general ledger and subsidiary records, and on the financial statements of the three funds. Specifically, FDIC has established materiality thresholds to determine whether or not to record known transactions and adjustments. Consequently, amounts considered immaterial by FDIC management were not processed during 1994, resulting in misstatements to the financial statements of the three funds.

For example, FDIC did not record adjustments of $62 million, $20 million, and $1 million, to BIF's, FRF's and SAIF's, financial statements, respectively, for known misstatements related to estimates of recoveries on failed institution assets. The formal adoption of a materiality threshold for posting transactions and adjustments increases the risk that management's assertions regarding financial statements are misstated. This in turn, increases the level of substantive audit procedures that must be performed by the auditor to conclude that the financial statements are fairly presented.

We suggest that FDIC management implement policies and procedures requiring the posting of all known misstatements. These policies and procedures should specifically prohibit the use of materiality thresholds for deciding which transactions should be reflected in the financial statements.

FDIC NEEDS TO ESTABLISH POLICIES AND PROCEDURES FOR ASSET SECURITIZATIONS

Sound internal control practices require that policies and procedures are properly developed, adequately documented, and fully implemented to provide reasonable assurance that resources are safeguarded against waste, loss, unauthorized use, and misappropriation.

During 1994, FDIC securitized a portion of BIF's portfolio of performing mortgages. This securitization transaction was FDIC's first security issue and, as such, presented unique control issues for which existing control mechanisms were not appropriate.

Although aware of this pending transaction, FDIC management did not develop and document policies and procedures to validate demands for payment and monitor recoveries. Specifically, FDIC did not establish policies and procedures to review guaranty payments,[1] principal and interest advances[2], and basis risk[3] support payments and recoveries for BIF's securitization transaction. In addition, personnel who will be responsible for reviewing and approving these demands informed us that they did not receive the training or resources necessary to effectively carry out their assigned responsibilities. Also, FDIC did not document its process for reviewing and accepting or rejecting the Resolution Trust Corporation's recommendation regarding claims for reimbursement under the warranty and representations provided by BIF.

Failure to develop, document, and implement policies and procedures to validate the propriety and accuracy of demands for payment regarding the securitization activity increase the risk that assets may not be adequately safeguarded and that transactions may not be properly authorized and recorded. While the value of the interest only securities and BIF's exposure under the guaranty and warranty and representations are not currently material, FDIC intends to offer additional security issues. Additional security issues,

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[1]Guaranty payments by BIF covering credit losses and certain expenses subrogates BIF to the certificate holders' rights to receive any payments or recoveries from the impaired loans.

[2]Cash advances by BIF to cover principal and interest shortfalls between scheduled loan payments and actual loan payments entitles BIF to reimbursement of amounts advanced from subsequent loan payments, liquidation proceeds, the guaranty, or the general funds of the trust.

[3]Basis risk covers shortfalls between stated interest payments and actual interest-related cash flows. Basis risk is payable to the extent that XS-Class certificate proceeds are available to BIF for the current distribution period. The transaction is structured so that the underlying mortgage rates less administrative costs are intended to be greater than the required certificate rates. The rights to any excess interest are represented by the XS Class certificates.

individually or in the aggregate, could materially affect BIF's future financial statements.

We suggest the FDIC develop, document, and implement policies and procedures for reviewing guaranty payments, principal and interest advances, and basis risk support payments and recoveries for BIF's securitization transaction.

POLICIES AND PRODECURES FOR CALCULATING RESERVES ON ASSETS FROM OPEN ASSISTANCE TRANSACTIONS DO NOT EXIST

Standard policies and procedures are necessary to ensure that FDIC personnel responsible for valuing assets acquired through open assistance transactions and deriving the related loss provisions for these assets are reviewing the same documentation, operating under comparable assumptions, and following a consistent methodology.

In open assistance transactions, FDIC acquires assets, such as notes receivables and stock certificates, as a result of assisting troubled institutions in an effort to avert their failure. In our 1992 financial audit, we noted that FDIC did not have documented policies and procedures describing how recovery values for these assets were established.[4] In response to the concerns we raised, FDIC management indicated that the Division of Resolution, in close coordination with the Division of Finance, would draft specific written policies to address our concerns. However, as of the end of our 1994 audit in March 1995, FDIC had not established written policies to estimate recovery values for open-assistance related assets. Lack of a written policy increases the risk that estimated recovery values for these assets are not based on uniform and reasonable criteria.

We suggest that FDIC develop and implement a specific written policy covering the valuation of open assistance-related assets and document a standard methodology for responsible personnel to follow in estimating recovery values for these assets.

[4]1992 Financial Statement Audit Management Letter (GAO/AIMD-94-30ML, January 24, 1994).

OTHER ISSUES

TRANSACTIONS WERE NOT ALWAYS PROPERLY REVIEWED, APPROVED, AND PRESENTED

Sound internal controls require that procedures exist to verify that transactions are adequately reviewed and properly authorized and recorded. However, during our 1994 and 1993 audits, we found errors in recorded transactions. For example, a $4.63 million transaction for BIF in 1993 was inappropriately recorded on FDIC's FIS as $463 million. FDIC's journal entry review and approval process did not detect this error. While the error was corrected on FIS in 1994 prior to the issuance of BIF's 1993 financial statements, the relevance of this error to the 1993 financial statements was not communicated to the Division of Finance's Financial Reporting Branch. Consequently, this error was reflected in BIF's 1993 financial statements.

Inadequate review and approval of transactions increase the risk that (1) assets may not be safeguarded against loss from unauthorized use, (2) transactions may not be executed in accordance with management's authority, and (3) transactions may not be properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles.

We suggest that FDIC ensure that (1) all transactions are properly reviewed and approved in accordance with current FDIC policy and (2) the significance of adjusting entries is considered and communicated to the Financial Reporting Branch.

WRITE-OFF ACTIVITY IS NOT REVIEWED ON A MONTHLY BASIS

FDIC's large contracted asset servicers[1] provide a monthly list of asset write-off activity to FDIC in addition to a monthly report reflecting aggregate write-offs. FDIC's COMB reconciles this list to the servicers' monthly activity reports and performs limited verification procedures for a judgmental sample of write-offs.

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[1]FDIC contracts with large asset servicers under an "Asset Liquidation Agreement"; small asset servicers are contracted under a "Regional Asset Liquidation Agreement."

These review procedures serve as a control to ensure the accuracy, validity, and approval[2] of the servicers' activity.

During 1994, we found that similar controls were not in place for Regional Asset Liquidation Agreement (RALA) contractors. Specifically, RALA contractors did not provide a detailed list of write-off activity, thus preventing FDIC from reviewing such activity associated with the RALAs. Consequently, FDIC had no assurance during 1994 that write-offs reported by RALA contractors were correct, valid, and properly approved. This increases the risk of additional loss to BIF.

We suggest that FDIC (1) require all asset servicers to provide a detailed asset list of write-offs that reconciles to the servicers monthly activity report and (2) verify the reasonableness of this reconciliation and review supporting documentation for a sample of write-off activity to ensure proper authorization and validity.

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[2]Each servicing agreement requires FDIC approval for write-offs exceeding a servicer-specific dollar threshold. However, the majority of write-offs do not require FDIC approval because they do not exceed the applicable threshold.

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