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

Accounting and Information
Management Division

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B-261933

July 25, 1995

Mr. John E. Ryan
Deputy and Acting Chief Executive Officer
Resolution Trust Corporation

Dear Mr. Ryan:

On June 22, 1995, we issued our opinions on the Resolution Trust Corporation's 1994 financial statements and management's assertions regarding the effectiveness of its system of internal controls as of December 31, 1994. We also reported on the Corporation's compliance with selected laws and regulations during 1994 (GAO/AIMD-95-157, June 22, 1995).

The purpose of this letter is to advise you of certain matters identified during our audit and to suggest related improvements to strengthen the Corporation's internal control environment. These matters include the need to improve the accuracy of servicer asset information in the Controls Total Module (CTM), complete the reconciliation and settlement of National Sales transactions, perform appropriate account reconciliations, and ensure that environmental costs are adequately considered in the asset valuation process. Although these matters are not material in relation to the financial statements, they warrant the attention of management.

In addition, this letter provides further information related to weaknesses in the Corporation's general electronic data processing (EDP) controls which were discussed in our June 1995 report. In that report, we discussed the general nature of the EDP weaknesses and recommended that the Corporation's staff monitor the implementation and progress of proposed corrective actions. Because the RTC Information Resources Management function merged with the Federal Deposit Insurance Corporation's (FDIC) Division of Information Resources Management on June 25, 1995, we are providing additional information on the EDP weaknesses to enhance RTC's efforts to monitor the implementation and progress of the corrective actions.

We have discussed the matters addressed in this letter with Corporation officials and have included their comments where appropriate.

CTM PROCEDURES WERE NOT CONSISTENTLY APPLIED

The CTM serves as an important link between the Corporation's general ledger and receivership asset balances reported by individual asset servicers based on their detailed subsidiary systems. Asset information reported by each servicer is entered and maintained in CTM as "Subsidiary System of Record" (SSR) balances. The Corporation's policy requires that the SSR balances and related information in CTM be updated to accurately reflect the servicers' ending balances upon receipt of updated servicer asset information. After updating the SSR balances and related information, the Corporation performs monthly reconciliations between the its recorded receivership asset balances and the related SSR balances to help ensure the accuracy and reliability of the Corporation's general ledger.

In our review of 290 sampled items, we found six instances in which the December 31, 1994, SSR balances recorded in CTM did not agree with the servicers' supporting documentation which resulted in a $10.3 million net understatement of the recorded SSR balances. These errors resulted from staff either not performing procedures in accordance with the Corporation's policies or performing them incorrectly. For example, we found that staff used incomplete or incorrect servicer records to update CTM and/or lacked a detailed understanding of the required procedures resulting in incorrect postings. These errors reduce the effectiveness of the monthly reconciliation process by creating unidentified and unreconciled differences between the Corporation's recorded CTM asset balances and the related SSR balances. However, the Corporation has other controls over its recorded general ledger balances to provide reasonable assurance that its general ledger balances are not materially misstated.

In addition to the errors described above, we found sixteen less significant errors in our sample related to other information maintained in CTM. For example, we found nine SSR balances where the delinquency status reflected in CTM did not agree with the servicers' records; six cases where the number of assets per the servicer records did not match the asset count recorded in CTM; and one case where the Corporation's ownership interest in an asset was not correctly recorded.

While the overall error rate this year was lower than the error rate reported in our 1993 audit results, unidentified and unreconciled differences, as well as, inaccuracies in the other CTM data warrants continuing management attention. This is especially true as the Corporation prepares for the transfer of assets, liabilities, personnel, and systems to FDIC at December 31, 1995. We suggest that the Division of Chief Financial Officer place additional emphasis on maintaining internal controls over entering and reconciling servicer asset information in CTM as the Corporation proceeds with its downsizing and transition activities. We also suggest that management reemphasize and monitor existing policies and procedures and reiterate the importance of accurately updating the SSR ending balances.

RECONCILIATION AND SETTLEMENT OF NATIONAL SALES TRANSACTIONS NOT COMPLETE

Since the inception of its National Sales program in 1991, the Corporation has sold assets with book values totaling approximately $49 billion through 109 major National Sales transactions. The Corporation has reconciliation and settlement procedures to determine the proper segregation of amounts due the Corporation or the servicers for the transactions. The Corporation considers settlement to be complete only after all parties to the transactions have agreed and formally acknowledged an amount to be exchanged between the parties.

Two tasks must be completed in order for the settlement to occur. First, the Office of Field Accounting and Asset Operations (FAAO) and individual servicers must separately reconcile the loans sold in each transaction and formally agree to an amount to be exchanged. To assist both the Corporation and servicers in completing their respective reconciliations, the Corporation created the National Sales Support Office (NSSO) which coordinates document retrieval efforts and consolidates the completed corporate and servicer loan reconciliations. Second, after each transaction has been fully reconciled and agreed to by all parties to the transactions, the Division of Asset Management and Sales must approve each National Sales transaction for final settlement.

As of June 30, 1995, the Corporation had completed its reconciliation for all loans sold for 45 of the 109 National Sales transactions. However, only four of these transactions had been finally settled. This is largely due to the time needed to assemble and distribute extensive supporting documentation, complete servicers' reconciliations, and reach agreement on the amounts to be exchanged. To improve the timeliness of the reconciliation and subsequent settlement process, the NSSO created a seven member unit which focuses on obtaining and providing all the necessary supporting documentation. Until the reconciliation and settlement of these asset sales are performed, the Corporation will not be certain that the transactions have been accounted for completely and accurately.

As the Corporation continues to downsize and prepare for its transition to FDIC, completing the work needed to settle these transactions will likely become increasingly difficult. Key documentation located in the closing field offices is likely to become more difficult to retrieve, and staff familiar with the transactions may no longer be available. Any remaining unsettled transactions will become FDIC's responsibility. We suggest that the Chief Financial Officer and the Vice President of the Division of Asset Management and Sales continue to place emphasis and allocate sufficient resources to complete the needed reconciliations and settlements of the National Sales transactions.

ADEQUATE PETTY CASH FUND RECONCILIATION WAS NOT PERFORMED

For all corporate balance sheet accounts, the Corporation requires that the Corporate Accounting Unit (CAU) prepare monthly reconciliations of recorded general ledger balances to the underlying, detailed accounting records. These reconciliations help to ensure that the Corporation's financial statements are accurately stated and also help to ensure that assets are safeguarded against loss, unauthorized use, and misappropriation.

The Corporation maintains petty cash funds at its headquarters and each of its field offices. During our audit, we found that the CAU did not perform a monthly reconciliation of the overall petty cash account balance. Instead, each month the CAU prepared an account analysis which compared the general ledger balance in the petty cash account to the authorized balances for the individual petty cash funds maintained at headquarters and each field office. Detailed reconciliations of the individual offices' petty cash funds were prepared and submitted as supporting documentation when the offices requested funds to replenish their petty cash fund balances. However, at no time during the year was an overall reconciliation of the petty cash account performed. Not preparing an overall petty cash account reconciliation increases the risk that loss or unauthorized use could occur and not be detected in a timely manner.

We do not believe the monthly account analysis, as prepared and discussed above, provides any assurance that the Corporation's petty cash balance is accurately stated or adequately safeguarded since each office only provides CAU with a statement specifying the authorized balance for its respective petty cash funds. Accordingly, we suggest that the CAU stop relying on the monthly account analysis and revise its reconciliation policies to, at a minimum, require the preparation of an overall year-end petty cash reconciliation. This reconciliation should include records of the actual cash balance at each field office plus a detailed accounting of the unreimbursed expenditures made from the petty cash funds. We also suggest that the Corporation continue its current practice of having each office submit a detailed reconciliation of its individual petty cash fund whenever replenishment funds are requested.

EQUITY ACCOUNT RECONCILIATIONS LACK PROPER SUPPORTING DOCUMENTATION

During our audit, we found that two of the Corporation's equity accounts, Invested Capital and Capital Certificates Issued, were not properly reconciled. This occurred because detailed accounting records were not maintained for these accounts. The Invested Capital account is used to record the appropriated funds the Corporation receives from the U.S. Treasury, and the Capital Certificates Issued account is used to record the issuance of Capital Certificates to the Resolution Funding Corporation.

Currently, the lack of detailed, subsidiary records precludes the Corporation from effectively reconciling these two equity accounts, thus increasing the risk that the balances could be misstated and not be detected and corrected in a timely manner. In addition, when the Corporation's financial records are transferred to FDIC, there will be no detailed records to support the transferred balances in these accounts.

We suggest that the CAU develop and maintain detailed records for both the Invested Capital and Capital Certificates Issued accounts. The detailed records for the Invested Capital account should include a listing of all appropriated funds received and citations to relevant legislation. The detailed records for the Capital Certificates Issued account should include a listing of all certificates issued with the issuance dates and dollar amounts that tie to the actual certificates. We also suggest that the CAU prepare periodic account reconciliations using these subsidiary records.

PROBLEMS WITH ASSET MANAGER ACCOUNT RECONCILIATIONS MAY IMPEDE THE CLOSEOUT OF ASSET MANAGER CONTRACTS

The Corporation has contracted with many private firms to manage portions of the Corporation's inventory of assets. In fulfilling their responsibilities, these firms routinely receive proceeds from the sale of assets which are subsequently transferred to the Corporation. The firms also receive advances and/or reimbursements from the Corporation to finance maintenance and other costs related to the assets included in the contracts. To facilitate the transfer of funds to and from the Corporation, accounts have been established at the Federal Home Loan Bank of Chicago (FHLB) for each of these contracts. As part of the contracts, the Corporation requires the asset managers to reconcile the FHLB accounts to the Corporation's Asset Manager System (AMS) monthly.

Standardized monthly reconciliation formats have been established as well as policies requiring supervisory reviews of completed reconciliations. In addition, to comply with the Corporation's contract closeout policies, the asset managers must provide a final reconciliation of all receipts and disbursements from the FHLB accounts at the end of their contracts. The monthly reconciliation process, if performed in a correct and timely manner, should facilitate this closeout process.

The Corporation's Division of Asset Management and Sales (AMSD) has the primary oversight responsibility for these contracts and is responsible for ensuring that the asset managers comply with the Corporation's existing policies and procedures. The Office of Field Accounting and Asset Operations is responsible for monitoring and/or reviewing the necessary AMS information and financial records to assist the asset managers and AMSD in ensuring that the asset managers are following the required AMS policies and procedures.

During our audit, we reviewed reconciliations prepared by 16 different asset management companies and determined that 14 of the companies did not fully comply with the Corporation's AMS reconciliation policies and procedures. For example, we found that 6 firms did not prepare the required reconciliations and that the Corporation resorted to either preparing the reconciliations in-house or to hiring other firms to complete the required reconciliations. We found that all but two of the other firms which did prepare reconciliations, including those hired specifically for that purpose, prepared the reconciliations incorrectly. For example, the firms either failed to use the Corporation's standardized reconciliation format, did not perform or document the required supervisory reviews, and/or did not provide supporting documentation for each component of the reconciliations. These AMS reconciliation problems, if not corrected, could impede the timely and orderly closeout of the asset manager contracts, which generally expire during 1995.

The Corporation, through its own internal reviews, identified many of the same problems and has taken steps to ensure asset managers' compliance with established policies and procedures. Therefore, we suggest that the Corporation's Division of Asset Management and Sales continue to monitor the progress of contractor corrective actions related to reconciliation problems identified by the Corporation. Further, we suggest that the Corporation's Office of Field Accounting and Asset Operations cooperate and assist in identifying and retrieving the necessary information and financial records to perform and/or complete the reconciliations.

NO FORMAL PROCEDURES TO ENSURE THAT COSTS OF ENVIRONMENTALLY IMPAIRED ASSETS ARE ACCRUED

Generally accepted accounting principles require the Corporation to record probable and estimable losses arising from environmental hazards associated with its assets. Some of the real estate assets owned by the Corporation's receiverships have environmental hazards such as lead, asbestos, or underground storage tanks. Generally, the Corporation incurs losses related to environmental hazards in one of two ways. The Corporation can either dispose of an impaired asset at a reduced market value commensurate with the cost of remediation or pay the cost of remediation and then dispose of the asset at a presumably higher market value. The Corporation's Real Estate Owned Management System (REOMS)--a subsidiary ledger for real estate owned assets--is used, in part, to flag assets with potential environmental problems for tracking purposes.

In general, the Corporation's asset valuation process, which is based on a statistical sampling of receivership assets, requires that all relevant information in an asset file be considered in valuing the assets. However, the valuation procedures do not require any specific steps to determine whether real estate owned assets are environmentally impaired and, if so, their remediation-related costs. As a result, under the Corporation's current procedures, the valuation process might not consider environmental costs if the asset files did not contain the information. Further, the Corporation does not have any other procedures to ensure that appropriate environmental costs are included in the Corporation's loss allowance.

We suggest that the Corporation's asset valuation procedures be modified to ensure that pertinent environmental information related to sampled assets be fully considered and documented in the asset valuation process. Also, we suggest that the Corporation perform an overall review to ensure that its loss allowance adequately reflects all probable and estimable losses arising from environmentally impaired assets.

EDP CONTROL WEAKNESSES AND SYSTEM EXPOSURES EXIST

General EDP controls consist of policies and procedures applicable to the overall effectiveness and security of an entity's automated system operations. General controls create the operating environment for application controls and certain user controls. General controls include an organization's structure, operating procedures, software security, system development and change control, and physical safeguards. Collectively, general controls are designed to ensure that only authorized changes are made to computer programs, access to data is appropriately restricted, back-up and recovery plans are adequate to ensure the continuity of essential operations, and physical protection of facilities is provided.

Access to Systems Was Not Adequately Restricted

Access controls are designed to limit access to an entity's system documentation, files, programs, and hardware. Weaknesses in or the absence of such controls increases the opportunity for unauthorized modifications to files and programs and/or misuse of the computer hardware. Weaknesses in access controls also decrease the integrity of the system.

While the Corporation's processes and procedures generally ensure access is limited to authorized individuals, we noted several conditions during our 1994 audit which increased the potential for unauthorized access to the Corporation's systems. We found the following:

-- An excessive number of system users had been given special system privileges. For example, 1 of the Corporation's 11 user IDs with special access privileges had been shared with 12 different individuals.

-- An unprotected computer library contained a user ID and password with special system privileges. These privileges included the ability to access and/or modify system data.

-- Eleven of the 231 employees whose employment with the Corporation ended during December 1994 had the capability to access RTC systems as of January 31, 1995.

-- Unattended and inactive terminals connected to certain of the Corporation's computer systems were not automatically disconnected in a timely manner as required.

These shortcomings reduce system integrity by exposing the Corporation's systems to potential access by unauthorized users and unauthorized modification of sensitive systems data.

<u>Some Program Changes Were Not Performed in Accordance With Policies and Procedures</u>

The Corporation has established system development and maintenance policies and procedures to ensure that all program development and maintenance activities are appropriately authorized, approved, tested, and recorded.

While most of the program changes we tested as part of our 1994 audit followed the Corporation's policies and procedures, we found three instances where the policies and procedures were not followed. We found one instance each where (1) all the appropriate requester approvals were not present, (2) formal documentation could not be located by the Corporation, or (3) evidence that changes were tested prior to installation could not be found. We also found that regular periodic reviews of reports, which can help identify unauthorized program changes, were not done. As a result, some changes made to applications may not have been authorized, supported, tested, or recorded appropriately.

<u>Access to Systems Software Was Not Adequately Restricted</u>

After operating and application system programs and related datasets have been generated and installed within a data processing facility, their integrity should be preserved. Systems software, by its nature, is extremely complex and sensitive to even minor modification. To ensure integrity is maintained, formal procedures for requesting, authorizing, and approving all changes to system programs and datasets should be established and maintained.

While the Corporation has implemented formal access and monitoring procedures, we found, in our review of selected application systems, that general users who do not need or require access could, under certain circumstances, obtain access to certain systems software and sensitive datasets. For example, unauthorized users were potentially able to issue job processing commands, such as, starting or stopping certain financial application programs and reading sensitive datasets. In addition, we found that the Corporation did not effectively monitor access to sensitive software files and utility programs. These weaknesses increase the risk that unauthorized changes to systems software and data files could occur and not be detected in a timely fashion.

The Corporation responded promptly to the general EDP control weaknesses we identified by developing a corrective action plan and implementing a majority of the plan's corrective actions. Before completing our field work in June 1995, we found that the Corporation's corrective actions had addressed several of the weaknesses we identified. The remaining corrective actions, when properly implemented and maintained, will strengthen general EDP controls in all applications.

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We are sending copies of this letter to the Chairman and members of the Thrift Depositor Protection Oversight Board; the Chairman and members of the Audit Committee, Resolution Trust Corporation; the Chief Financial Officer, Resolution Trust Corporation; the Inspector General, Resolution Trust Corporation; and the senior members of the Federal Deposit Insurance Corporation/Resolution Trust Corporation Transition Task Force.

We would appreciate receiving your comments as well as a description and status of the Corporation's planned corrective actions within 30 days from the date of this letter. We acknowledge the cooperation and assistance the Corporation's management and staff provided during our 1994 audit. If you have any questions or need assistance in addressing these matters, please contact me at (202) 512-9406 or John Reilly, Assistant Director, at (202) 512-9517.

Sincerely yours,

Robert W. Gramling

Robert W. Gramling
Director, Corporate Financial Audits

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