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United States Government Accountability Office
Washington, DC 20548

April 18, 2011

Mr. Timothy G. Massad
Acting Assistant Secretary
for Financial Stability
Office of Financial Stability
Department of the Treasury

Subject: *Management Report: Improvements Are Needed in Internal Control Over Financial Reporting for the Troubled Asset Relief Program*

Dear Mr. Massad:

The Emergency Economic Stabilization Act of 2008 (EESA)¹ requires that we annually audit the financial statements² of the Troubled Asset Relief Program (TARP), which is implemented by the Office of Financial Stability (OFS).³ On November 15, 2010, we issued our audit report⁴ including (1) an unqualified opinion on OFS's financial statements for TARP as of and for the fiscal years ended September 30, 2010, and 2009, and (2) an opinion that OFS maintained effective internal control over financial reporting as of September 30, 2010. We also reported that our tests of OFS's compliance with selected provisions of laws and regulations for the fiscal year ended September 30, 2010, disclosed no instances of noncompliance.

Our November 2010 audit report concluded that although certain internal controls could be improved, OFS maintained, in all material respects, effective internal control over financial reporting as of September 30, 2010, that provided reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements would be prevented or detected and corrected on a timely basis. Our audit report also

¹Pub. L. No. 110-343, Div. A, 122 Stat. 3765 (Oct. 3, 2008), *codified in part, as amended*, at 12 U.S.C. §§ 5201-5261.

²Section 116(b) of EESA, 12 U.S.C. § 5226(b), requires that the Department of the Treasury (Treasury) annually prepare and submit to Congress and the public audited fiscal year financial statements for TARP that are prepared in accordance with generally accepted accounting principles. Section 116(b) further requires that GAO audit TARP's financial statements annually in accordance with generally accepted auditing standards.

³Section 101 of EESA, 12 U.S.C. § 5211, established OFS within Treasury to implement TARP.

⁴GAO, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Years 2010 and 2009 Financial Statements*, [GAO-11-174](#) (Washington, D.C.: Nov. 15, 2010).

identified a significant deficiency⁵ in OFS's internal control over its accounting and financial processes.

This report presents (1) more detailed information concerning underlying specific control deficiencies that contributed to the significant deficiency identified in our audit report, along with related recommendations for corrective actions; (2) other less significant control deficiencies that we identified during our audit, along with related recommendations for corrective actions; and (3) the status, as of November 5, 2010, of corrective actions taken by OFS to address the 20 recommendations that were detailed in our June 2010 management report.⁶ While the deficiencies we identified are not considered material weaknesses, they nonetheless warrant management's attention and action. The 9 recommendations presented in this report are in addition to those we have made as part of the series of reports issued on our ongoing oversight of TARP.⁷

Results in Brief

During fiscal year 2010, OFS addressed one of the two significant deficiencies that we reported in December 2009 on the results of our audit for fiscal year 2009,⁸ and made progress in addressing the other. Specifically, OFS sufficiently addressed the issues regarding OFS's verification procedures over the data used for asset valuations such that we no longer consider this area to be a significant deficiency as of September 30, 2010. OFS completed corrective action on both of the related recommendations during fiscal year 2010. In addition, OFS addressed many of the issues related to the other significant deficiency we reported for fiscal year 2009 concerning its accounting and financial reporting processes. OFS completed corrective action on 12 of the 15 recommendations regarding this significant deficiency during fiscal year 2010. However, the remaining 3 uncorrected control deficiencies along with other control deficiencies that we identified in this area in fiscal year 2010 collectively represented a continuing significant deficiency in OFS's internal control over its accounting and financial reporting processes. Specifically, we found:

- While improvements were noted in OFS's review and approval process for preparing its financial statements, notes, and management's discussion and analysis (MD&A) for TARP from what we had found for fiscal year 2009, we continued to identify incorrect

⁵A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

⁶GAO, *Management Report: Improvements Are Needed in Internal Control Over Financial Reporting for the Troubled Asset Relief Program*, GAO-10-743R (Washington, D.C.: June 30, 2010).

⁷Section 116(a) of EESA, 12 U.S.C. § 5226(a), requires GAO to report at least every 60 days on TARP activities and performance. Products and recommendations related to GAO's oversight of TARP are available on GAO's Web site at <http://www.gao.gov>.

⁸GAO, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements*, GAO-10-301 (Washington, D.C.: Dec. 9, 2009).

amounts and inconsistent disclosures in OFS's draft financial statements, notes, and MD&A that were significant, but not material, and that were not detected by OFS.

- For fiscal year 2009, we reported that OFS had not finalized its procedures related to its process for accounting for certain program transactions, preparing its September 30, 2009, financial statements, and its oversight and monitoring of financial-related services provided to OFS by asset managers and certain financial agents. During fiscal year 2010, we found that most of these procedures were finalized. However, we identified instances where OFS's procedures were not always followed or effectively implemented.
- OFS's documentation was incomplete for certain areas of its asset valuation process. Specifically, some valuation methodology changes and the basis for certain assumptions derived from informed opinion that were used in valuing TARP's assets were not included in its written documentation.⁹ After we notified OFS that the documentation was incomplete, it was able to provide adequate additional information about its asset valuation process.
- OFS did not have adequate procedures to determine whether the tool and related guidance it used properly calculated valuations for certain TARP assets with projected future disbursements.¹⁰ OFS's use of the tool and related guidance resulted in errors in the valuation of such assets.

OFS had other controls over TARP transactions and activities that reduced the risk of misstatements in its financial statements resulting from these deficiencies. For significant errors and issues that were identified, OFS revised the financial statements, notes, and MD&A, as appropriate.

In addition to the significant deficiency, we identified other less significant control deficiencies related to (1) documenting and communicating financial-related housing program issues, and (2) calculating the housing program accrual. During fiscal year 2010, OFS addressed two of the three less significant control deficiencies that we reported in our June 2010 management report.¹¹

We are making 7 new recommendations related to OFS's significant deficiency and 2 related to the other less significant control deficiencies. Further, our work showed that OFS had completed corrective action on 16 of the 20 recommendations and corrective actions were in progress on the 4 remaining recommendations from our fiscal year 2009 TARP financial statements audit work. Enclosure I of this report summarizes the status of actions taken as of November 5, 2010, on the recommendations from our fiscal year 2009 TARP financial statements audit work. We plan to follow up to determine the status

⁹Informed opinion refers to the judgment of agency staff or others who make subsidy estimates based on their programmatic knowledge, experience, or both. Informed opinion is considered an acceptable approach under Federal Accounting Standards Advisory Board Technical Release 6 when adequate historical data do not exist.

¹⁰The tool and related guidance used by OFS in its TARP asset valuation process is provided to federal agencies for performing valuations under the Federal Credit Reform Act of 1990, 2 U.S.C. §§ 661-661f.

¹¹[GAO-10-743R](#).

of corrective actions taken for the open recommendations during our fiscal year 2011 audit of OFS's financial statements for TARP.

In commenting on a draft of this report, the Acting Assistant Secretary for Financial Stability stated that OFS concurred with the recommendations in our draft report. The Acting Assistant Secretary also stated that OFS began taking actions related to these recommendations in January 2011 following the release of our audit report and expects to have implemented the corrective actions for all recommendations by September 30, 2011.

Scope and Methodology

As part of our audit of OFS's fiscal years 2010 and 2009 financial statements for TARP, we evaluated the design and operating effectiveness of OFS's internal control over financial reporting. We tested relevant internal controls over financial reporting, including those designed to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in conformity with U.S. generally accepted accounting principles (GAAP), and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with the laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements.

We did not evaluate all internal controls relevant to operating objectives as broadly established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting and may not be sufficient for other purposes. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness. Because of inherent limitations, internal control may not prevent or detect and correct misstatements due to error or fraud, losses, or noncompliance. Additional details on our audit methodology can be found in our November 2010 audit report.¹²

We performed our audit of OFS's fiscal years 2010 and 2009 financial statements for TARP in accordance with U.S. generally accepted government auditing standards. We believe that our audit provided a reasonable basis for our conclusions in this report.

We requested comments on a draft of this report from the Acting Assistant Secretary for Financial Stability. In a letter dated April 13, 2011, OFS commented on our draft report. OFS's comments are reprinted in enclosure II.

Significant Deficiency

During fiscal year 2010, OFS addressed many of the issues related to the significant deficiency we reported in December 2009 on the results of our fiscal year 2009 audit

¹²[GAO-11-174](#).

related to its accounting and financial reporting processes.¹³ However, three control deficiencies remained as of September 30, 2010. Those remaining deficiencies combined with other control deficiencies in this area that we identified in fiscal year 2010, collectively represent a significant deficiency in OFS's controls over its accounting and financial reporting processes. Specifically, the significant deficiency is composed of control deficiencies in the following areas: (1) financial statement review and approval process (2) implementation of required procedures for certain key accounting and financial reporting processes (3) documentation for certain areas of OFS's asset valuation processes and (4) evaluating the results from calculations of certain asset valuations. The following sections present additional information concerning these control deficiencies that collectively represented the significant deficiency we identified, along with our related recommendations for corrective actions.

Financial Statement Review and Approval Process

While we found improvements in OFS's review and approval process for preparing its financial statements, notes, and MD&A for TARP from what we had found for fiscal year 2009, we continued to identify significant, but not material, errors in reported amounts and inconsistent disclosures in OFS's 2010 draft financial statements, notes, and MD&A that were not detected by OFS. The Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*,¹⁴ provides that agencies are to ensure that information in the financial statements is presented in accordance with GAAP for federal entities. Without an effectively implemented review and approval process for preparing financial statements and related disclosures, an agency is at risk of presenting information that is inaccurate, inconsistent, or not in conformity with GAAP.

We reaffirm our recommendation from our June 2010 management report that the Assistant Secretary for Financial Stability direct the Chief Financial Officer (CFO) to establish a mechanism for the effective implementation of the review and approval process for preparing the year-end financial statements and related disclosures, including MD&A, for TARP.¹⁵

Implementation of Required Procedures for Certain Key Accounting and Financial Reporting Processes

For fiscal year 2009, we reported that OFS had not finalized its procedures for accounting for certain program transactions, preparing its September 30, 2009, financial statements, and its oversight and monitoring of financial-related services that asset managers and certain financial agents provided to OFS.¹⁶ During fiscal year 2010, we found that most of these procedures were finalized. However, we identified instances where OFS's procedures were not followed or effectively implemented. *Standards for*

¹³GAO-10-301.

¹⁴OMB Circular No. A-136, *Financial Reporting Requirements* (Revised September 2010), establishes a central point of reference for federal financial reporting guidance for executive branch agencies required to submit audited financial statements.

¹⁵GAO-10-743R.

¹⁶GAO-10-301.

Internal Control in the Federal Government provides that federal entities should have control activities that enforce management's directives and help ensure that actions are taken to address risks.¹⁷ The standards further provide that control activities should be an integral part of an entity's planning, implementing, reviewing, and accountability for stewardship of government resources and achieving effective results. We found the following areas where OFS's procedures were not always followed or effectively implemented:

- **Implementation of internal control process.** OFS adopted a framework for organizing the development and implementation of its systems of internal control using GAO's standards for internal control and the guidance in OMB Circular No. A-123, *Management's Responsibility for Internal Control* (A-123). OFS has A-123-related policies and procedures that require it to measure compliance with internal control standards as well as compliance with its own policies. This is a significant component of OFS's required procedures for evaluating and reporting on internal control over financial reporting. As part of forming an opinion on the effectiveness of OFS's internal control, we evaluated OFS's A-123 process. We found that OFS had designed an extensive A-123 process, which included OFS identifying its key internal controls, evaluating the design of the internal controls, and testing the operating effectiveness of its internal controls based on its own policies and procedures. However, as part of OFS's execution of its A-123 process, we found OFS did not always ensure consistency between its A-123 documentation and its policies and procedures. For example, within OFS's A-123 documentation, OFS identified that a certain form was required to be completed as part of a specific accounting function, whereas the related accounting policies and procedures did not require completion of such a form. In addition, in some cases we found inconsistencies between the actual practices carried out by OFS personnel and the related accounting policies and procedures.

Furthermore, we found that OFS's A-123 testing of the operating effectiveness of key internal controls was not always effective. During fiscal year 2010, we tested these same key internal controls over financial reporting that OFS tested as part of its A-123 process and found that in some instances our results differed from OFS's. For example, we noted several exceptions in operating effectiveness when we tested OFS's journal entry review and approval controls, whereas the OFS review did not identify any exceptions based on its own testing of these controls. As such, we concluded the testing performed by OFS was not always properly executed in accordance with its policies and procedures.

Without adequate assurance that its A-123 documentation, policies and procedures, and practices employed by OFS personnel are consistent and effectively implemented, OFS may not appropriately identify deficiencies in design or operating effectiveness of internal controls over financial reporting, which could increase the risk of misstatements in OFS's financial statements for TARP.

¹⁷GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999), contains the internal control standards to be followed by executive agencies in establishing and maintaining systems of internal control as required by 31 U.S.C. § 3512 (c), (d) (commonly referred to as the Federal Managers' Financial Integrity Act of 1982).

- **Period-end reconciliations.** OFS procedures require performing several general ledger reconciliations as part of its period-end financial statement close process. However, we found several key required reconciliations were reviewed and approved by individuals who were not designated to perform the reviews according to OFS's policies and procedures. We also found some reconciliations that, although reviewed and approved by the designated official, contained undetected errors. While these errors caused misstatements to the draft financial statements, OFS corrected the errors in its final financial statements for TARP. To the extent OFS's reconciliation process does not result in effectively identifying, and, where necessary, resolving reconciling items, it could increase the risk of misstatements in OFS's financial statements for TARP.
- **Journal entry review and approval.** OFS's policies and procedures prescribe documentation and reviews required for proposed journal entries. However, we found instances in which reviewed and approved journal entries included supporting documentation that did not agree with the proposed journal entries' amounts. Upon further inquiry and investigation, OFS was able to provide the documentation supporting the journal entry amounts. Ineffective implementation of OFS's policies and procedures related to the review and approval of journal entries increases the risk that erroneous journal entries may be recorded in the general ledger.

Recommendations for Executive Action

We recommend that the Acting Assistant Secretary for Financial Stability direct the CFO to:

- Establish a mechanism for ensuring that OFS personnel follow prescribed policies and procedures for (1) documenting execution of its A-123 process and thereby ensuring consistency among its A-123 documentation, existing policies and procedures, and actual practices executed by OFS personnel; and (2) performing testing on the operating effectiveness of OFS's key internal controls in accordance with its A-123-related policies and procedures.
- Establish a mechanism for ensuring (1) that only those individuals specifically designated in OFS's policies and procedures to review and approve period-end reconciliations conduct such procedures and (2) effective review of period-end reconciliations by the designated official.
- Establish a mechanism for ensuring effective reviews of documentation attached to journal entries, including ensuring such reviews assess whether the supporting documentation is sufficient and consistent with the journal entry before such entries are recorded in the general ledger.

Documentation for Certain Areas of OFS's Asset Valuation Processes

During our audit of OFS's fiscal year 2009 financial statements for TARP, we found OFS's documentation was incomplete for certain areas of its asset valuation process, including documenting its basis for certain assumptions derived from informed opinion that were used in valuing TARP assets. We made two recommendations in our related June 2010

management report regarding this issue.¹⁸ OFS took action in fiscal year 2010 related to these previous recommendations, but neither of these prior recommendations was fully addressed during fiscal year 2010 (see recommendations 09-6 and 09-12 in table 1 of enclosure I of this report for further information). We also identified two new control deficiencies related to OFS's documentation of its asset valuation process in fiscal year 2010. Specifically, as discussed in the following sections, the new control deficiencies in this area concerned (1) changes in OFS's model assumptions and data sources that were not fully documented or reflected in OFS's economic and financial model, and (2) changes in asset valuation methodology that were not adequately documented.

Changes in OFS's Model Assumptions and Data Sources Not Fully Documented or Reflected in OFS's Economic and Financial Model

OFS uses economic and financial models to value TARP's equity investments and the models incorporate various assumptions in determining valuations. OFS's policies and procedures include requirements for documenting the economic and financial models used, including data sources used to develop the assumptions incorporated into the models. During fiscal year 2010, OFS changed its data source for dividend yields used in the warrant valuation calculations, which also changed the basis of the dividend yield assumption from a quarterly yield to an annualized yield. However, OFS did not update all of its initial model documentation to accurately reflect the new data source and the new basis for the assumption. In addition, OFS did not update the formulas in the model to reflect the change to the use of an annualized yield in the warrant value calculation. The continued use of a quarterly yield in the model formulas resulted in an error in the draft warrant valuation. *Standards for Internal Control in the Federal Government* states that all transactions and other significant events are to be clearly documented, and the documentation should be readily available for examination and that events should be accurately recorded. We brought this matter to the attention of OFS management and they took action to correct these errors in the final economic and financial model formulas and the related documentation. To the extent that changes in any aspect of the model and data are not properly documented, reviewed, and approved, the risk to OFS that undetected financial reporting misstatements could occur is increased.

Recommendation for Executive Action

We recommend that the Acting Assistant Secretary for Financial Stability direct the CFO to:

- Establish a mechanism for ensuring that changes to the assumptions used in the economic and financial models, and to data used in the models are properly documented in accordance with OFS policies and procedures.
- Establish a mechanism for ensuring that the economic and financial models are accurately updated to reflect any changes made to the data and/or assumptions used in the models in accordance with OFS policies and procedures.

¹⁸ [GAO-10-743R](#).

Change in Automotive Industry Financing Program Asset Valuation Methodology Not Adequately Documented

During fiscal year 2010, OFS changed its valuation methodology for certain investments under the Automotive Industry Financing Program (AIFP). However, OFS did not document the change or the reason for the change in accordance with OFS's policies and procedures. The initial AIFP valuation assumption documentation provided that certain investments were to be valued using the OFS economic and financial model used to value equity investments. However, in a later update in fiscal year 2010, OFS changed the AIFP valuation to be based on an external asset manager valuation. However, OFS did not document the rationale for the change in valuation methodology as required. Specifically, OFS's Office of Credit Modeling and Analysis's policies and procedures relating to changes in the model valuation provides that, "Documentation will include the reason for the change, a description of the change, how the change was implemented, and the resulting impact to subsidy rates." After we notified OFS that the documentation was incomplete, it was able to provide adequate additional information about its asset valuation process, including the rationale for the change, in accordance with its policies and procedures. The absence of supporting documentation could result in incorrect assumptions and estimates, leading to incorrect valuations and inaccurate AIFP information in OFS's financial statements.

Recommendation for Executive Action

We recommend that the Acting Assistant Secretary for Financial Stability direct the CFO to establish a mechanism for ensuring that changes in OFS's AIFP valuation methodology, including the rationale for the changes, are documented in accordance with OFS policies and procedures.

Evaluating the Results from Calculations of Certain Asset Valuations

The economic and financial models that OFS uses to value TARP assets result in estimated cash flows over the life of the asset. OFS values these assets under Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees*. Under SFFAS No. 2, assets should include only amounts disbursed and outstanding. In addition, OFS is required to use the OMB Credit Subsidy Calculator 2 (CSC2)¹⁹ to calculate the present value of the estimated cash flows and use that calculation as the basis for the asset valuation recorded in its financial statements. However, including future disbursements in its estimated cash flows based on OMB's CSC2 guidance resulted in significant valuation errors for certain OFS direct loan and equity investment programs in OFS's draft reporting at the end of the fiscal year. OFS did not have a mechanism for ensuring that asset valuations only considered amounts outstanding as of fiscal year end in accordance with SFFAS No. 2. In its final fiscal year 2010 financial reporting, OFS corrected the significant errors we had identified.

¹⁹OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, Section 185.2, states that under the Federal Credit Reform Act of 1990, "Present values must be calculated using the OMB Credit Subsidy Calculator 2."

Recommendation for Executive Action

We recommend that the Assistant Secretary for Financial Stability direct the CFO to establish a mechanism for ensuring that asset valuations for certain direct loan and equity investment programs only reflect amounts outstanding as of fiscal year end in accordance with SFFAS No. 2.

Other Control Deficiencies

In addition to the significant deficiency, we identified other control deficiencies that were not considered material weaknesses or significant deficiencies, but nevertheless warrant OFS management's attention and action. Specifically, as discussed in the following sections, we identified deficiencies concerning OFS controls over (1) documenting and communicating financial-related housing program issues, and (2) calculating the housing program accrual.

Documenting and Communicating Financial-Related Housing Program Issues

OFS's Home Affordable Modification Program (HAMP) Compliance Committee is to meet every week to discuss issues related to TARP's housing programs, including issues that could have a financial statement impact. The HAMP Compliance Committee charter provides that the committee is responsible for capturing the notes of committee meetings with special emphasis on the rationale behind any decisions that were made as well as any follow-up assignments, and that notes will be distributed within 2 days of the meeting. However, we found that OFS's Compliance Committee meeting minutes were not presented at the level of detail specified in the HAMP Compliance Committee charter, and were often distributed at least 2 months after the date of the meeting. Furthermore, we identified a housing-related issue with a direct financial statement impact that was not documented in the meeting minutes. We did, however, learn that this issue was discussed between the Office of the Chief Financial Officer and the Office of Internal Review's (OIR) Director of Compliance, the Chair of the Compliance Committee, separate from the Compliance Committee meetings and the financial statement impact was considered.

According to the *Standards for Internal Control in the Federal Government*, information should be recorded and communicated to management and to others within the entity who need it, and the information should be in a form and within a time frame that enables them to carry out their internal control and other responsibilities efficiently.

To the extent OFS does not document and communicate relevant housing-related financial statement information to the appropriate parties in a timely manner, management may be impaired in its ability to perform its responsibilities efficiently and effectively. Furthermore, as issues in the housing program area are revisited during the course of the fiscal year, or as personnel changes occur, thorough and consistent documentation will help to ensure that housing-related decisions are adequately considered, implemented appropriately, and reflected as appropriate in OFS's financial statements.

Recommendation for Executive Action

We recommend that the Acting Assistant Secretary for Financial Stability direct the OIR to establish a mechanism for ensuring that any housing program issues discussed at the OFS Compliance Committee meetings, which could have a financial statement impact, are sufficiently communicated to all applicable officials in OFS within 2 days as specified in the HAMP Compliance Committee charter.

Calculating the Housing Program Accrual

OFS's financial statements are to include an accrued liability for unpaid amounts due as part of TARP's housing programs. The liability should reflect periodic housing program incentive payments which generally have specified time frames as outlined in housing program guidelines. During fiscal year 2010, OFS calculated the monthly accrual for the TARP housing programs and compared its calculation to the monthly accrual calculated by the housing program system, IR2 (maintained by a third-party administrator). OFS performed these procedures for approximately 9 months of fiscal year 2010, and calculation errors noted by OFS were corrected in IR2. After OFS determined that IR2 was calculating the accrual amounts correctly, OFS relied on IR2 and indicated that it did not have plans to continue the recalculations and comparisons for future periods. However, OFS did not verify through its comparison procedures whether the accrual calculated by IR2 would appropriately account for mortgages with incentive payments that reach the maximum incentive payment amounts. For example, one particular housing program incentive is paid annually for a period of up to 2 years from the date the mortgage enters the housing program. OFS procedures did not provide for verifying whether or not IR2 would cease accruing for this incentive amounts once the 2-year period had elapsed.

Standards for Internal Control in the Federal Government states that management needs to comprehensively identify risks and should consider all significant interactions between the entity and other parties as well as internal factors at both the entitywide and activity level. Once risks have been identified, they should be analyzed for their possible effect.

For fiscal year 2010, no housing program incentive payments had reached the maximum incentive payment amount, thus there was no financial statement risk associated with the related fiscal year 2010 accrual. However, if OFS does not address this risk in the near future, the housing accrual amounts reported in the financial statements for subsequent years may be overstated.

Recommendation for Executive Action

We recommend that the Acting Assistant Secretary for Financial Stability direct the CFO to verify that the accrual calculated by IR2 appropriately accounts for mortgages which have reached their maximum incentive payment amounts.

Agency Comments

In commenting on a draft of this report, the Acting Assistant Secretary for Financial Stability stated that OFS concurred with the recommendations in our draft report. The Acting Assistant Secretary also stated that OFS began taking actions related to these

recommendations in January 2011 following the release of our audit report and expects to have implemented corrective actions for all recommendations by September 30, 2011. We plan to follow up to determine the status of corrective actions taken for these matters during our fiscal year 2011 audit.

This report is intended for use by OFS management. We are sending copies of this report to interested congressional committees and members, the Secretary of the Treasury, Inspector General of the Department of the Treasury, Acting Special Inspector General for TARP, Congressional Oversight Panel, Financial Stability Oversight Board, Director of the Office of Management and Budget, and others. In addition, this report is available at no charge on GAO's Web site at <http://www.gao.gov>.

We acknowledge and appreciate the cooperation and assistance provided by OFS management and staff during our audits of OFS's fiscal years 2010 and 2009 financial statements for TARP. If you have questions about this report, please contact me at (202) 512-3406 or engelg@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in enclosure III.

Sincerely yours,



Gary T. Engel
Director
Financial Management and Assurance

Enclosures - 3

Enclosure I – Status of Recommendations from Our Prior Year Management Report

Our fiscal year 2010 audit included a review to update the status of the Office of Financial Stability's (OFS) corrective actions to address the recommendations from our June 2010 management report.²⁰ Table 1 summarizes the recommendations included in that report, including the status of the recommendations according to OFS, as well as our own assessment. In all instances, we agreed with OFS's assessment of the status of the recommendation. In summary, 16 of the 20 recommendations have been closed, and 4 remain open. We will continue to monitor OFS's progress in addressing the open recommendations as part of our fiscal year 2011 financial statements audit.

Table 1: Status of Recommendations from Our Prior Year Management Report
(as of November 5, 2010, the date of our audit report)

Count	Number	Recommendation	Status of recommendation	
			Per OFS	Per GAO
GAO-10-743R (TARP Fiscal Year 2009 Management Report)				
1	09-1	Establish a mechanism for the effective implementation of the review and approval process for preparing the year-end financial statements and related disclosures, including management discussion and analysis, for TARP.	Open. During fiscal year 2011, OFS will define all review tasks and develop checklists for the review and assembly of necessary documentation supporting the review and approval of year-end financial statements.	Open.
2	09-2	Develop and implement written procedures for identifying and evaluating modifications of direct loans, equity investments, and asset guarantees, to include: specific roles and responsibilities, criteria to identify modifications, documentation of management review and approval, and documentation of Office of Management and Budget approval of the modification subsidy cost estimate.	Closed.	Closed.
3	09-3	Finalize and implement OFS's draft written procedures for identifying and evaluating any subsequent events that could have an effect on asset valuations and related disclosures.	Closed.	Closed.
4	09-4	Develop and implement written procedures for tracking the resolution of independent verification and validation findings related to OFS's economic and financial models used for valuing TARP direct loans, equity investments, and asset guarantees.	Closed.	Closed.

²⁰GAO, *Management Report: Improvements Are Needed in Internal Control Over Financial Reporting for the Troubled Asset Relief Program*, GAO-10-743R (Washington, D.C.: June 30, 2010).

Count	Number	Recommendation	Status of recommendation	
			Per OFS	Per GAO
5	09-5	Update existing procedures to include procedures for identifying and resolving economic and financial model error and warning messages, including requirements to maintain appropriate supporting documentation regarding the resolution of such instances.	Closed.	Closed.
6	09-6	Update OFS's asset valuation procedures to include specific requirements for documenting the basis of economic and financial model assumption values derived from informed opinion consistent with <i>FASAB Technical Release 6</i> .	Open. During fiscal year 2011, OFS will update its procedures to include a requirement to document the sources of informed opinion and the basis for the assumptions used and will summarize the basis used on the assumption tables.	Open.
7	09-7	Develop and implement written procedures for presenting income from direct loans and trust preferred securities in the Statement of Net Cost.	Closed.	Closed.
8	09-8	Develop and implement written procedures for identifying any year-end dividends declared but unpaid to OFS from TARP participants.	Closed.	Closed.
9	09-9	Develop and implement written procedures for disclosing accrued interest receivable, dividends declared but unpaid, and, if applicable, distributions receivable from trust preferred securities in OFS's financial statements for TARP.	Closed.	Closed.
10	09-10	Finalize and implement procedures for the preparation of the year-end financial statements to include all key preparation processes.	Closed.	Closed.
11	09-11	Develop and implement, as part of OFS's oversight and monitoring activities, written procedures detailing steps to effectively oversee and determine the reasonableness of data provided by external asset managers, prior to the use of such data.	Closed.	Closed.
12	09-12	Develop and implement written procedures to document the rationale for established thresholds used in determining whether to investigate differences between the asset manager valuations and OFS's internally developed asset valuations.	Open. During fiscal year 2011, OFS will consider lowering the established threshold used in determining whether to investigate differences between the asset manager valuations and OFS's internally developed asset valuations and implement written procedures to document the rationale for the established threshold.	Open.

Count	Number	Recommendation	Status of recommendation	
			Per OFS	Per GAO
13	09-13	Develop and implement written procedures detailing steps to be performed in overseeing and monitoring OFS's financial agents, Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), including internal controls over the existence and completeness of loan data used in the determination of the HAMP liability.	Closed.	Closed.
14	09-14	Develop written procedures for periodically estimating the HAMP liability.	Closed.	Closed.
15	09-15	Develop and implement procedures to segregate the responsibilities for recording, approving, and reconciling of information maintained in the accounting database used by OFS in the asset valuation process.	Closed.	Closed.
16	09-16	Enhance and implement specific written procedures to verify data inputs, including manual inputs, used in the economic and financial models for the valuation of TARP direct loans, equity investments, and asset guarantees, and help ensure that such verification is clearly documented.	Closed.	Closed.
17	09-17	Assess manual inputs used in the economic and financial models for the valuation of TARP direct loans, equity investments, and asset guarantees to determine the feasibility of reducing the number of manual inputs.	Closed.	Closed.
18	09-18	Develop, document, and implement a mechanism to track the location of executed agreements.	Open. During fiscal year 2011, OFS will finalize a procedure to address the tracking of executed agreements. Additionally, the Office of the Chief Counsel has developed depository forms to assist with document tracking and Bank of New York Mellon will hire a contractor to perform enhanced monitoring.	Open.
19	09-19	Develop and implement written procedures specifying detailed steps to be followed to reasonably ensure that warrant adjustments are properly recorded in the accounting database OFS uses for valuing TARP assets.	Closed.	Closed.
20	09-20	Establish procedures to effectively monitor the documentation of reconciliations of key documents related to disbursements to and refunds from The Bank of New York Mellon as prescribed in OFS's written procedures.	Closed.	Closed.

Source: GAO.

Enclosure II – Comments from the Office of Financial Stability



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

April 13, 2011

Mr. Gary T. Engel
Director, Financial Management and Assurance
U.S. Government Accountability Office

Dear Mr. Engel:

We have received a copy of your draft report entitled *Management Report: Improvements Are Needed in Internal Control Over Financial Reporting for the Troubled Asset Relief Program* (GAO-11-434R).

We are pleased that you noted in your report that the Office of Financial Stability (OFS) received unqualified opinions on both the OFS FY 2010 financial statements and internal controls over financial reporting and no identified instances of noncompliance with selected provisions of laws and regulations.

We have reviewed the detailed recommendations that you have provided regarding the one significant deficiency you identified during your FY 2010 audit and regarding other less significant control deficiencies. We concur with your draft recommendations.

Through coordination with your staff and our understanding of the Matters for Further Consideration that we responded to during the FY 2010 audit, we began taking actions on the recommendations in January 2011 immediately after your final report was released. We have made necessary improvements to our processes and procedures. We expect to implement the majority of other necessary changes by June 30, 2011 and any remaining changes by September 30, 2011.

Sincerely,

A handwritten signature in black ink, appearing to read "Tim Massad".

Timothy G. Massad
Acting Assistant Secretary
Office of Financial Stability

Enclosure III – Staff Acknowledgments

The following individuals made major contributions to this report: Marcia L. Carlsen, and Lynda E. Downing (Assistant Directors), as well as Tony J. Eason, Aaron M. Livernois, Mary O. Osorno, Rebecca A. Riklin, and Anne Y. Sit-Williams.

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