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GAO

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

Accounting and Information
Management Division

B-240108

August 30, 1994

Ms. Donna Cunninghame
Chief Financial Officer
Resolution Trust Corporation

Dear Ms. Cunninghame:

In June 1994, we issued our opinions on the Resolution Trust Corporation's 1993 financial statements and internal controls as of December 31, 1993, and reported on the Corporation's compliance with selected laws and regulations during 1993 (GAO/AIMD-94-148, June 27, 1994). The purpose of this letter is to report to you other matters identified during our audit regarding accounting procedures and internal controls which could be improved and to make suggestions for improvement. While the following matters are not considered material in relation to the Corporation's financial statements, we believe they warrant management's attention.

CHIEF FINANCIAL OFFICER INVOLVEMENT IN THE ESTIMATED CASH RECOVERY CALCULATION

The estimated cash recovery (ECR) calculation is a key factor in estimating loss funds and recoveries from the Corporation's receiverships. Although these estimates are significant to the Corporation's financial statements, which are prepared by the Chief Financial Officer (CFO), the CFO has not had direct involvement in planning or analyzing the results of the ECR calculation. The responsibility for performing the ECR calculation lies with the Office of Planning, Research, and Statistics (OPRS), which reports to the Deputy Chief Executive Officer of the Corporation.

The initial confidence interval determined as part of the June 1993 ECR calculation was \$3.1 billion compared to \$1.8 billion at December 1992. The confidence interval represents the upper and lower bounds of a statistically based estimate. A large confidence interval means that the reported estimates of loss funds and recoveries from receiverships have a larger margin of error. The CFO did not initially consider the impact of this wide margin of error on the estimates. Additional analysis revealed that a calculation error had been made and that the revised confidence interval actually showed a smaller margin of error. The CFO, recognizing the significance of the ECR calculation to the estimates reported in the financial statements, is in the process of drafting a plan which provides for the CFO's increased involvement in the ECR calculation.

We suggest that the CFO complete the draft plan and implement procedures to work with the OPRS in planning and analyzing the results of future ECR calculations.

INTEREST INCOME ON SUBROGATED CLAIMS RECEIVABLES

Generally accepted accounting principles require that interest income on receivables be recognized when the earnings process is complete. The Corporation's practice is to delay the recognition of any interest income on subrogated claims receivables until the related receiverships are terminated and final dividends are received. The Corporation considers the earnings process to be complete at that time because the collection of the interest income generally is not certain until the final dividends are received. Generally, the Corporation calculates the amount of interest income earned as the excess of total recoveries from the receivership over the subrogated claims receivable.

In some cases, however, the Corporation recovers more than the subrogated claims receivable before receipt of the final dividend. Under the Corporation's current practice, these excess recoveries are recorded in a contra-asset account and are not reclassified to interest income until the final dividend is received even though the recoverability of the receivable is no longer uncertain and the earnings process is complete. Because of this practice, the Corporation understated its 1993 interest income on subrogated claims receivables by approximately $5.6 million.

We suggest that the Corporation's Field Accounting Section periodically review the subrogated claims receivable balances to identify situations in which actual recoveries exceed the recorded receivable balances prior to receipt of the final dividend. In these situations, we suggest that the Corporation immediately record the interest income for the excess recoveries.

RECONCILIATIONS OF NON-CASH RECOVERIES ON SUBROGATED CLAIMS

For most corporate general ledger accounts, the Corporation requires that the Corporate Accounting Unit (CAU) reconcile the recorded balances with the subsidiary records each month. During our audit, we found that the CAU did not prepare the required monthly reconciliations of account 060109, Non-cash Recoveries on Subrogated Claims. This account is used to record the receipt of non-cash dividends and offsets of preferred claims.

These reconciliations were not prepared because the subsidiary records provided to the CAU were inadequate. These records had not been updated in a timely manner and contained incomplete information. If this account is not reconciled, there is an increased risk that misstatements in the recorded account balance will not be identified and corrected in a timely manner.

Recognizing the need to reconcile this account, the Corporation implemented procedures in May 1994, to create and maintain a new subsidiary system of record for non-cash recoveries on subrogated claims. The new subsidiary system of record is maintained by the field offices and consists of monthly logs of non-cash dividends and preferred claims paid to the Corporation. These monthly logs are submitted to the CAU for use in preparing the monthly reconciliations.

The new subsidiary system of record, if properly maintained, should enable the CAU to prepare the required monthly reconciliations. We suggest that the CAU monitor the logs prepared by the field offices to ensure that they are submitted to the CAU in a timely manner and contain all the information needed for the reconciliation process.

MISCLASSIFICATIONS BETWEEN CASH AND NON-CASH RECOVERIES ON SUBROGATED CLAIMS

The Corporation has two separate general ledger accounts to distinguish between cash and non-cash recoveries on subrogated claims. We found that misclassified transactions between the two accounts, which amounted to approximately $5.4 million at December 31, 1993, had not been corrected for receiverships which had been terminated because the general ledgers for the receiverships had been closed. As a result, the general ledger balances for the two accounts were misstated as of December 31, 1993. Although the amounts which should be reclassified did not have an effect on the Corporation's statement of financial position, the misclassifications did impede the preparation of the Corporation's statement of cash flows.

We suggest that the Corporation's Office of Accounting Services temporarily reopen the general ledgers for the terminated receiverships and correct the misclassifications.

GENERAL LEDGER ADJUSTMENTS REFLECTED IN THE FINANCIAL STATEMENTS

Generally accepted accounting principles require that transactions be recorded in the accounting period in which they occur. However, we found that several general ledger adjustments identified during the December 31, 1993, reconciliation process were not reflected in the 1993 financial statements. For example, accounts payable had not been adjusted for approximately $31,000 of voided checks. This occurred because the Corporation does not have procedures to notify the Financial Reporting Unit of adjustments identified during the monthly reconciliation process. The unrecorded adjustments we found were not material to the December 31, 1993, financial statements. However, there is a risk that adjustments might not be recorded in a timely manner in the future.

We suggest that procedures be established to require that all general ledger adjustments identified during the monthly reconciliation process be forwarded to the Financial Reporting Unit to ensure that all adjustments are considered in preparing the financial statements.

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We are sending copies of this letter to the Deputy and Acting Chief Executive Officer, Resolution Trust Corporation; the Inspector General, Resolution Trust Corporation; and the Thrift Depositor Protection Oversight Board.

We would appreciate receiving your comments and a description of the corrective actions the Corporation plans to take to address these matters within 30 days from the date of this letter. We acknowledge the cooperation and assistance the Corporation's management and staff provided during our 1993 audit. If you have any questions or need assistance in addressing these matters, please contact me at (202) 512-9406 or Christine Robertson, Audit Manager, at (703) 908-6164.

Sincerely yours,

Robert W. Gramling

Robert W. Gramling
Director, Corporate Financial
Audits

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