United States General Accounting Office

GAO

Report to the Congress

October 1991

FINANCIAL AUDIT

Resolution Trust Corporation's 1990 Financial Statements

145192

GAO/AFMD-92-20

GAO

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

Comptroller General
of the United States

B-240108

October 25, 1991

To the President of the Senate
and the Speaker of the House of Representatives

This report presents the results of our audit of the financial statements of the Resolution Trust Corporation for the year ended December 31, 1990. We have found it necessary to disclaim an opinion on all statements except the statement of cash flows. Our audit disclosed that significant uncertainties exist affecting the Corporation's cost estimates for resolving institutions and that the Corporation lacked certain critical internal controls during 1990. These uncertainties and control weaknesses precluded us from forming an opinion on the Corporation's estimated recoveries from receiverships for claims paid on behalf of depositors and on its estimated liability for unresolved institutions. The proper valuation of real estate assets is a major concern. Due to the continuing weakness in the economy and the seriously overbuilt real estate market, factors over which the Corporation has no control, present estimates of recovery value for these assets are problematic. To address the identified internal control weaknesses, the Corporation recently instituted new policies and procedures at its receiverships and has revised its valuation methodology. We will test these areas as part of our 1991 audit.

We conducted our audit pursuant to the provisions of section 21A(k)(1) of the Federal Home Loan Bank Act (12 U.S.C. 1441a(k)(1)) and in accordance with generally accepted government auditing standards. The act requires that we issue our audit opinion on the Corporation's statements no later than June 30 of the year following the year under audit. However, the Corporation was unable to provide us with financial statements or information on its newly revised methodology for calculating estimated recoveries from receivership assets until late May 1991. As a result, we could not begin the audit work required to test that methodology until June 1991. To avoid similar delays in the 1991 audit, the Corporation has improved several of its financial reporting operations. For example, it has refined its valuation methodology and plans to produce receivership recovery estimates quarterly instead of at year-end only. We will work with the Corporation throughout the 1991 audit to meet the June 30, 1992, reporting requirements.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Public Law 101-73), also known as FIRREA, created the Resolution Trust Corporation to resolve the problems of failed thrift institutions previously insured by the Federal Savings and Loan Insurance Corporation and placed into conservatorship or receivership between January 1, 1989, and August 9, 1992. The Resolution Trust Corporation Oversight Board, under the chairmanship of the Secretary of the Treasury, has overall responsibility for the Corporation's activities. The Federal Deposit Insurance Corporation carries out the Resolution Trust Corporation's duties and responsibilities and is reimbursed for all services performed.

The Corporation's 1990 financial statements indicate that it could incur up to $158 billion in losses for probable and possible resolution actions. The Corporation has been provided with $80 billion to resolve failing thrifts. In September 1991, the Corporation requested another $80 billion to cover all of the expected and possible losses associated with the thrift industry cleanup. Of the latter amount, $60 billion relates to institutions the Corporation did not consider probable or likely resolution candidates as of December 31, 1990. We have not independently determined how much of this $60 billion is now required for resolution activity. The Corporation has reported to us that it is nearly out of funds. The Corporation has also requested that its working capital borrowing authority be increased to $160 billion. The Corporation assumes it will recover enough from the sale of receivership assets to repay the working capital it borrows from the Federal Financing Bank (FFB). However, if receivership assets bring in less than expected, the Corporation will have to request additional funding for losses to repay FFB borrowings. Even though it is not possible to determine the eventual funding requirements with a reasonable degree of accuracy, the Corporation will only be able to continue its resolution activities if it receives funding promptly.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Banking, Finance and Urban Affairs; the Chairman and members of the Resolution Trust Corporation's Oversight Board; the Director of the Office of Thrift Supervision; and the Director of the Office of Management and Budget.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

Contents

Abbreviations

FASB	Financial Accounting Standards Board
FFB	Federal Financing Bank
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
FIS	financial information system
FSLIC	Federal Savings and Loan Insurance Corporation
SAIF	Savings Association Insurance Fund

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of the United States

B-240108

To the Board of Directors
Resolution Trust Corporation

We have audited the accompanying statement of financial position of the Resolution Trust Corporation as of December 31, 1990, and the related statement of revenue, expenses and accumulated deficit and the statement of cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. In addition, we are reporting on our consideration of the Corporation's internal control structure and on its compliance with laws and regulations.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

Due to internal control weaknesses and significant uncertainties affecting the recovery values of troubled real estate assets, we were not able to assess the reasonableness of the Corporation's estimated recoveries from receiverships or its estimated liability for unresolved institutions. Because these control weaknesses and uncertainties could have a material effect on the Corporation's financial statements, we are declining to issue an opinion on whether its statements of financial position and of revenue, expenses and accumulated deficit are fairly presented.

Value of Recoveries From Receivership Assets Uncertain

Our work indicates that the Corporation's estimated recoveries from receivership assets could be overstated due to the lack of strong internal controls over receivership operations, flaws in the Corporation's methodology for determining the recovery value of receivership assets, and significant uncertainties related to the performance of the economy in general and real estate markets in particular. For institutions already resolved, the Corporation paid out the funds required to settle depositor claims either to the depositors themselves or to the acquirers of the institutions. The Corporation then has a claim against the receivership[1] in the amount of depositor liabilities paid. The Corporation's estimated recoveries from receiverships are recorded as receivables on its balance sheet.

Based on our limited control testing performed in early 1991, we found that receiverships lacked strong controls during 1990 in many key areas related to cash receipts, disbursements, and beginning balances. As a result, we cannot be reasonably sure that the amounts the receiverships reported are accurate or that receiverships have collected all that they should. In response to our initial findings, discussed in greater detail in our report on the Corporation's internal control structure, the Corporation instituted new control policies and procedures in receiverships and consolidated offices. We have expanded our testing of receivership internal control systems in our audit of the Corporation's 1991 financial statements.

We have reservations about the methodology the Corporation used to estimate the recovery value of receivership assets. In general, the Corporation sampled and valued assets from its 20 largest receiverships and then projected the results of the sample to the assets of its 352 receiverships. However, the Corporation cannot state with any confidence that valuation results from this nonstatistical sample of receiverships are representative of the assets of nonsampled receiverships. In addition, the Corporation was unable to reconcile the universe of assets used to select the sample for valuation in individual receiverships with the universe of assets recorded in the Corporation's general ledger at that date. We cannot determine whether these methodological shortcomings had a material effect on the recovery values reported by the Corporation. In response to these concerns, the Corporation changed its methodology for estimating asset recovery values in June 1991. We will evaluate its new procedures in our 1991 financial audit.

We are also concerned with the valuation of individual receivership assets—particularly real estate related assets. At December 31, 1990, Corporation receiverships held assets with a book value of $58 billion, of which $8 billion were real estate owned and another $8 billion were delinquent real estate-backed loans. Many delinquent loans are likely to become receivership owned real estate through foreclosure proceedings.

[1]Corporation receiverships are separate legal entities responsible for managing and selling the failed institution's assets and paying off its creditors. The Corporation has merged about half of its receiverships into 15 consolidated offices.

Although the Corporation adjusts receivership assets from book to market value based on appraisals or other standard valuation procedures, neither they nor we can be reasonably sure that these values reflect recoveries under present economic conditions.

The continuing weakness in the economy and the seriously overbuilt real estate market will have a significant effect on Corporation recovery values. The Resolution Trust Corporation, the Federal Deposit Insurance Corporation, and other government and private entities have growing portfolios of troubled assets, including vast amounts of real estate. Given the market problems, the income flows from many of these properties may never support the valuations that were assigned to them when they first entered the government inventory. The Corporation must compete with the growing number of distressed sellers and institutions seeking to liquidate their holdings. To address market problems, the Corporation has adopted a policy of aggressively discounting real estate assets up to 50 percent of appraised value, which could also have a significant effect on recovery values. Due to these factors, many of which are beyond the Corporation's control, the best estimates of recovery values could be significantly overstated.

Future Resolution Costs Uncertain

To estimate its liability for the cost of unresolved institutions at December 31, 1990, the Corporation used an appropriate methodology. In general, the Corporation assumed that 375 institutions in conservatorship or considered likely conservatorship candidates would require resolution during the period January 1, 1991, through August 9, 1992. In calculating its liability for these resolutions, the Corporation assumed that the losses related to these failures had been incurred as of December 31, 1990, and that it would recover approximately the same percentage of book value from the sale of assets in these institutions as it expected to recover from similar assets in already resolved institutions. The Corporation disclosed in the notes to its statements that another 400 institutions could possibly fail.

The Corporation's estimate of the number of probable and possible thrift failures was determined according to generally accepted accounting principles. However, as with recoveries from already resolved institutions, the accuracy of the Corporation's cost estimates depends on the outcome of various uncertainties, principally the weak economy and depressed real estate markets. Real estate owned and delinquent real estate-backed loans in Corporation conservatorships totaled $9 billion and $8 billion, respectively, at December 31, 1990. The remainder of both probable and possible resolution candidates at that date held $395 billion in assets, nearly 30 percent of which, based on historical percentages, were likely to be real estate and delinquent real estate-backed loans subject to foreclosure. Due to the large exposure to real estate losses, even the best current cost estimates for resolving failed thrifts could be significantly understated. Unexpected losses on asset sales could substantially increase the Corporation's future funding needs. The depressed commercial real estate market and the Corporation's aggressive discounting policy make it likely that additional losses will be incurred.

Corporation Presentation of Certain Asset Purchase Transactions Is Questionable

The appropriateness of the Corporation's accounting for transactions related to the purchase of assets and assumption of liabilities at resolution is questionable. In general, the Corporation must pay the acquirer of a failed institution's deposit liabilities an amount equal to the deposits accepted. The Corporation then has a claim against the receivership of the failed institution in an amount equal to the total depositor liabilities paid.

In practice, however, the acquiring institution generally accepts some of the failed institution's assets instead of cash for part of the Corporation's payment. In these cases, the Corporation pays the acquirer cash equal to the net amount of liabilities minus assets accepted. The Corporation currently considers an amount equal to the value of the assets transferred as "escrowed funds" held for receiverships and accrues interest on the balances outstanding. We question the Corporation's current policy of offsetting the escrowed fund balances against a portion of the receivables due from receiverships for depositor liabilities paid. This treatment reduced the Corporation's assets and liabilities by $32 billion on its December 31, 1990, balance sheet. We are working with Corporation management to determine how the amounts for assets transferred at resolution should be classified and presented in its financial statements. This accounting issue does not affect the Corporation's reported loss or its accumulated deficit at December 31, 1990.

GAO's Opinion

Because of the material effect the internal control weaknesses and the uncertainties previously discussed could have on the Corporation's estimated recoveries from the sale of its receivership assets and on its estimated amounts to be paid for unresolved institutions, we are unable to express, and we do not express, an opinion on the Corporation's financial position as of December 31, 1990, or its results of operations for the year then ended. Therefore, we caution users that the Corporation's accompanying statement of financial position and the related statement of revenue, expenses and accumulated deficit have limited reliability. However, in our opinion, the Corporation's statement of cash flows for the year ended December 31, 1990, presents fairly, in all material respects, its cash flows for that period in conformance with generally accepted accounting principles. It should be recognized that the cash flow statement reports only the cash actually received and disbursed by the Corporation. Due to weaknesses in controls previously mentioned, the Corporation may not be recovering all the revenue it should from its receiverships.

Our disclaimer of opinion on the Corporation's statement of financial position as of December 31, 1990, and its statement of revenue, expenses and accumulated deficit for the year then ended can be removed when, in our judgment, the Corporation has corrected receivership internal control weaknesses and has an adequate historical basis for its loss estimates for resolved and unresolved institutions. The Corporation can only get this experience by selling a significant and representative portion of its real estate and troubled loans secured by real estate in the currently depressed market.

Corporation Funding Needs

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Public Law 101-73, created the Resolution Trust Corporation on August 9, 1989. The Corporation was charged with resolving the problems of failed thrift institutions previously insured by the Federal Savings and Loan Insurance Corporation (FSLIC) and placed in conservatorship or receivership from January 1, 1989, until August 9, 1992. The Corporation's Oversight Board, under the chairmanship of the Secretary of the Treasury, has overall responsibility for the Corporation's activities. The Federal Deposit Insurance Corporation carries out the Resolution Trust Corporation's duties and responsibilities and is reimbursed for all services performed.

The Corporation's 1990 financial statements indicate that it could incur up to $158 billion in losses for required resolution actions. The Corporation estimated that it had already incurred losses of $42 billion for 352 institutions resolved between August 9, 1989, and December 31, 1990. In conjunction with these resolutions, the Corporation recorded a $54 billion liability for Federal Financing Bank (FFB) borrowings that funded the purchase of assets held for sale in Corporation receiverships. The Corporation expected the proceeds from the sale of receivership assets to cover the FFB working capital borrowings. If receivership assets bring in less than expected, the Corporation will have to request additional funding for losses from the Congress to repay FFB borrowings.

The Corporation also accrued a $56 billion liability for the cost of resolving 375 institutions which were in conservatorship or were considered probable future candidates for resolution. In addition, the Corporation recognized the possibility that another 400 open institutions may require government assistance and could result in losses to the Corporation of as much as an additional $60 billion.

The Corporation has been provided with $80 billion[2] to resolve failing thrift institutions and to pay its administrative expenses. On September 12, 1991, the Corporation and its Oversight Board testified before the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance, Committee on Banking, Finance and Urban Affairs. They asked the Congress to provide another $80 billion to cover all of the expected and possible losses associated with the thrift industry cleanup. Of this amount, $60 billion relates to institutions the Corporation did not consider probable or likely resolution candidates at December 31, 1990. We have not independently determined how much of the $60 billion is now required for resolution activity. The Corporation has reported to us that it is nearly out of funds. The Corporation also requested that its working capital borrowing authority be increased to $160 billion. In addition, the Oversight Board requested that the deadline for transferring thrifts to the Corporation for resolution be extended by 1 year. These requests were intended to allow the Corporation to complete the cleanup of insolvent institutions and allow the Savings Association Insurance Fund (SAIF)[3] to assume its responsibilities without a backlog of troubled thrifts to resolve.

How much additional funding the Corporation will require depends on a number of factors, particularly the outcome of the uncertainties related to the economy, the recovery value of assets, and the number and timing

[2]FIRREA provided the Corporation with $50 billion to resolve failed thrift institutions. An additional $30 billion was provided by the Congress as part of the Resolution Trust Corporation Funding Act of 1991.

[3]FIRREA created SAIF to replace the Federal Savings and Loan Insurance Corporation as the insurance fund for the thrift industry. However, SAIF has no significant responsibility for assisting and resolving troubled thrifts until August 9, 1992. Although FIRREA provided SAIF with several funding sources, none will supply significant revenue prior to fiscal year 1992. See Financial Audit: Savings Association Insurance Fund's 1989 Financial Statements (GAO/AFMD-91-31, March 1, 1991) for a discussion of SAIF's financial condition and funding mechanisms.

of additional thrift failures. These uncertainties also affect the time the Corporation needs to complete its work. Faced with these uncertainties, neither the Oversight Board nor the Corporation can provide assurance that the $80 billion loss fund request will be the final installment in resolving the thrift industry crisis.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

September 16, 1991

Report on Internal Control Structure

We have audited the financial statements of the Resolution Trust Corporation for the year ended December 31, 1990, and have issued our opinion thereon. This report pertains only to our study and evaluation of the Corporation's internal control structure for that period.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. In planning and performing our audit of the Corporation's financial statements for the year ended December 31, 1990, we considered its internal control structure in order to determine the auditing procedures needed for purposes of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

The Corporation's management is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the internal control structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For purposes of this report, we have classified the Corporation's significant internal control structure policies and procedures into the following categories:

- assistance to closed institutions, consisting of policies and procedures related to (1) liquidation activities for receiverships and (2) the valuation of the Corporation's net receivables from resolution transactions;

- assistance to open institutions, consisting of policies and procedures related to Corporation funds advanced to conservatorships to cover their liquidity needs or to replace high cost borrowings;
- liabilities for future resolutions, consisting of policies and procedures related to identifying and estimating the cost of future resolution candidates;
- borrowings from the Federal Financing Bank (FFB), consisting of policies and procedures related to the borrowing, use, and repayment of working capital;
- treasury/revenue, consisting of policies and procedures related to cash receipts and disbursements;
- expenditures, consisting of policies and procedures related to disbursements for administrative expenses; and
- financial reporting, consisting of policies and procedures related to the processing of journal entries into the general ledger and the preparation of financial statements.

For all internal control structure categories listed above, we obtained an understanding of relevant policies and procedures, determined whether they have been placed in operation, and assessed the associated control risk. We performed limited tests of control procedures for assistance to closed institutions, assistance to open institutions, borrowings from FFB, and financial reporting. However, we found it more efficient to rely solely on substantive audit tests of activities related to future resolutions, cash receipts/disbursements, and administrative expenses. For all categories, we performed audit tests to substantiate account balances associated with each control category. Such tests can also serve to identify weaknesses in the internal control structure. As discussed in the following paragraphs, our consideration of the Corporation's internal control structure revealed three reportable conditions.

Reportable Conditions

Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect an organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

There are basically two levels of reportable conditions—those that are considered material weaknesses,[4] which could affect the fair presentation of the financial statements, and those that, while not material, are significant matters that merit management's attention. We were unable to determine whether two of the conditions being reported had a material effect on the financial statements; however, their potential effect was material. These conditions concern (1) the lack of strong controls over cash receipts, disbursements, and beginning balances in Corporation receiverships and (2) flaws in the Corporation's methodology for determining the recovery value of individual receivership assets. We also found that the Corporation could not use its financial reporting system to prepare a statement of cash flows in accordance with generally accepted accounting principles. We determined that this condition did not constitute a material weakness.

Receiverships Lack Internal Controls

The Corporation could be overstating the amount it will recover from its receiverships because it did not have strong internal controls over receivership operations in 1990. Without strong control systems, receiverships might not recover all that they should due to fraud, mismanagement, or theft of assets.

In early 1991, we performed limited testing of internal control systems in three of the Corporation's consolidated offices[5] and found that they lacked key controls over cash receipts, disbursements, and receiverships' opening balances during the period covered by our financial audit.

- All three consolidated offices lacked fully developed, written procedures for handling check receipts. As a result, these offices did not adequately separate key duties for handling receipts. For example, the same cashier received checks, logged them in, prepared the bank deposit slips, deposited the checks, and prepared the journal entries to record the deposits in the general ledger. In all offices, lack of staff was cited as the reason for this control weakness.

[4]A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

[5]The Corporation has merged about half of its receiverships into 15 consolidated offices. According to Corporation officials, all receiverships in a consolidated office are subject to the same internal control policies and procedures.

- All three consolidated offices lacked adequate controls to ensure that duplicate payments were not made to vendors, servicers, or other recipients of funds from receiverships. For example, the three offices that we reviewed did not have adequate procedures in place to prevent or detect duplicate accounts payable entries. One of the offices simply relied on the accountant to recognize any duplicate payments being processed. Another office had the capability to list apparent duplicate invoices; however, at the time of our review, a listing had not been done for more than 2 months. The third office had no formal procedures in place.
- All three consolidated offices lacked documentation to support receiverships' beginning financial statement account balances. As a result, some receiverships' opening account balances for assets and/or liabilities could not be verified. For example, for 3 of the 17 account balances we tested for a receivership in one consolidated office, receivership personnel could not locate any information. Of the remaining 14 account balances, 2 did not have adequate support for adjusting entries. We found similar problems at the other two consolidated offices.

We provided the results of our internal control testing to the Corporation and its Oversight Board in June 1991. In response to our findings, Corporation headquarters personnel evaluated controls in all 15 consolidated offices and developed standard internal control policies and procedures for all offices to follow. We are performing an expanded review of receivership internal control systems as part of our 1991 financial statement audit.

Corporation's Estimation Methodology Is Flawed

The methodology used by the Corporation to determine the recovery value of individual receivership assets at December 31, 1990, was not statistically valid; therefore, the Corporation cannot state with any confidence that this methodology provided reasonable recovery rates that could be projected to nonsampled assets. Our review of the 1990 methodology indicated weaknesses that could have resulted in material differences to expected recoveries from receivership asset sales.

- The Corporation selected its 20 largest receiverships based on the book value of their assets at resolution as its sampling universe. Contractors then sampled and valued assets from predetermined asset categories in each of the 20 receiverships. Based on the results of the sampled asset valuations, the Corporation developed average recovery rates for asset types that were then projected to the assets of the 352 receiverships. However, because the receiverships were not selected statistically, the Corporation cannot state with any confidence that the results of asset valuation in sampled receiverships can be projected to the assets of non-sampled receiverships.

- The Corporation was unable to reconcile the universe of assets used to select the sample for valuation with the universe in its general ledger to which the valuation results were applied. Corporation receiverships maintain their own sets of books into which they enter information on asset transactions. These books supplied the asset listings from which the contractors selected the sample to be valued. Even though the receivership books were not reconciled to the Corporation's general ledger, the Corporation applied the results of the asset valuation sample to the general ledger balances to calculate its expected recovery from receiverships. The Corporation cannot state with confidence that the receivership recovery rates thus derived are reasonable.

We discussed our concerns regarding the methodology used for the 1990 recovery calculation with Corporation management and we plan to work with the Corporation before the December 31, 1991, recovery values are calculated to ensure that these design flaws have been corrected.

Corporation's Accounting System Does Not Support a Cash Flow Statement

The Financial Accounting Standards Board (FASB) Statement no. 95, Statement of Cash Flows, requires an entity to include a statement of cash flows when issuing a complete set of financial statements. The primary purpose of this statement is to provide relevant information about an entity's cash receipts and cash payments during a given period. In order to address the above requirement, the Corporation's financial information system (FIS) contains a reporting feature which segregates all transactions as either cash or noncash related.

Information in FIS could not be used to produce the statement of cash flows for the year ended December 31, 1990. Extensive reclassifications of the accounting entries within the system made the cash report it produced inaccurate and not useful. With the current system design, reclassified entries often result in miscoded cash and noncash related information. Therefore, the Corporation used an alternative method of analyzing other cash information produced internally, combined with a manual analysis of activity with the accounts tracked in FIS. This process did not allow the Corporation to present an acceptable cash flow statement until August 27, 1991, and resulted in duplication of effort for financial reporting and auditing.

The Corporation's alternative methods enabled it to produce a statement of cash flows for the year ended December 31, 1990, which we found to be fairly stated in all material respects in conformance with generally accepted accounting principles. The Corporation is currently developing a new system to process its accounting information. In conjunction with the new system, the Corporation is developing a methodology for producing the information necessary for a statement of cash flows. However, the new system will not be completed in time for its 1991 financial statements.

Report on Compliance With Laws and Regulations

We have audited the financial statements of the Resolution Trust Corporation for the year ended December 31, 1990, and have issued our opinion thereon. This report pertains only to our review of the Corporation's compliance with laws and regulations for that period.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The Corporation's management is responsible for compliance with laws and regulations. As part of obtaining reasonable assurance as to whether the financial statements were free of material misstatements, we selected and tested transactions and records to determine the Corporation's compliance with certain provisions of section 21A of the Federal Home Loan Bank Act (12 U.S.C. 1441a) which, if not complied with, could have a material effect on the Corporation's financial statements. However, our objective was not to provide an opinion on overall compliance with such provisions. Because of the limited purpose for which our tests of compliance were made, the laws and regulations tested did not cover all legal requirements with which the Corporation has to comply.

The results of our tests indicate that with respect to the items tested, the Corporation complied, in all material respects, with those provisions of laws and regulations that could have a material effect on its financial statements. With respect to transactions not tested, nothing came to our attention that caused us to believe that the Corporation had not complied, in all material respects, with those provisions.

Financial Statements

Statement of Financial Position

December 31, 1990
(In thousands)

Assets	
Cash	$ 5,176,794
Net advances and loans (Note 3)	22,608,018
Net subrogated claims (Note 4)	25,538,697
Other assets (Note 6)	6,409
Total Assets	$ 53,329,918
Liabilities	
Accounts payable, accrued liabilities and other	$ 41,822
Liabilities incurred from assistance and failures (Note 7)	490,897
Notes payable (Note 8)	53,929,779
Estimated cost of unresolved cases (Note 9)	55,941,445
Estimated losses from corporate litigation (Note 10)	158,184
Total Liabilities	110,562,127
Equity	
Contributed capital	18,810,090
Capital certificates	24,247,854
Accumulated deficit	(100,290,153)
Total Equity (Note 11)	(57,232,209)
Total Liabilities and Equity	$ 53,329,918

See accompanying notes

Statement of Revenue, Expenses and Accumulated Deficit

For the year ended December 31, 1990
(In thousands)

Revenue	
Interest on advances and loans	$ 1,378,623
Servicing and other revenue	25,258
Total Revenue	**1,403,881**
Expenses and Losses	
Interest expense on notes issued by the Corporation	1,787,516
Interest expense on escrowed funds	1,395,438
Provision for losses (Note 5)	(1,483,133)
Administrative operating expenses	53,944
Other expenses	12,530
Total Expenses and Losses	**1,766,295**
Net Loss	**(362,414)**
Accumulated Deficit - Beginning	**(99,927,739)**
Accumulated Deficit - Ending (Note 11)	**$ (100,290,153)**

See accompanying notes

Statement of Cash Flows

For the year ended December 31, 1990
(In thousands)

Cash Flows From Operating Activities:	
Cash inflows from:	
Receipts from subrogated claims	$ 1,879,579
Repayments of advances and loans, principal	7,198,660
Receipts of interest on advances and loans	1,160,395
Receipts from servicing and other operations	20,672
Cash outflows for:	
Disbursements for subrogated claims	(60,870,583)
Disbursements for advances and loans	(19,037,050)
Disbursements for reimbursable expenditures	(241,137)
Administrative operating expenditures	(32,480)
Net Cash Used by Operating Activities (Note 15)	**(69,921,944)**
Cash Flows From Financing Activities:	
Cash inflows from:	
Corporate notes payable	52,142,263
Capital certificates	18,539,096
Contributed capital	10,785
Cash Provided by Financing Activities	**70,692,144**
Net Increase in Cash	**770,200**
Cash - Beginning	**4,406,594**
Cash - Ending	**$ 5,176,794**

See accompanying notes

Notes to the Financial Statements

DECEMBER 31, 1990

1. Impact of FIRREA Legislation:

Creation of the RTC:

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) became public law on August 9, 1989. This landmark legislation established organizations and procedures to obtain and administer the necessary funding to resolve failed thrifts and to dispose of the assets of these institutions. FIRREA abolished the Federal Savings and Loan Insurance Corporation (FSLIC) and the Federal Home Loan Bank Board (FHLBB). Their functions were transferred, in a prescribed manner, to the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision, the Federal Housing Finance Board, and the Resolution Trust Corporation (RTC).

The RTC, a Government Corporation, was tasked with replacing the FSLIC in future case resolution activity by managing and resolving all troubled savings institutions that were previously insured by FSLIC and for which a conservator or receiver is appointed during the period January 1, 1989 through August 8, 1992.

The activities of the RTC are subject to the general oversight of the Oversight Board. The Oversight Board was created by FIRREA to oversee and be accountable for the RTC, to provide the RTC with general policy direction, and to review and monitor the RTC's performance. The Oversight Board consists of five members: the Secretary of the Treasury; the Chairman of the Board of Governors of the Federal Reserve System; the Secretary of Housing and Urban Development; and two independent members appointed by the President, with the advice and consent of the Senate.

FIRREA established the Resolution Funding Corporation (REFCORP) to provide the RTC with funds necessary to carry out its legislative mandate. The REFCORP, under the direction of the Oversight Board, was granted power to issue long-term debt securities. The net proceeds of these securities shall be used to purchase capital certificates issued by the RTC or to refund any previously issued obligation.

Under current law (FIRREA), the RTC will terminate on or before December 31, 1996. All remaining assets and liabilities will be transferred to the FSLIC Resolution Fund, with the requirement that any net proceeds from the sale of such assets be transferred to the Resolution Funding Corporation (REFCORP) for interest payments. At the time of the RTC's termination, the FDIC will succeed the RTC as conservator or receiver for failed thrift activity.

Source of Funds:

The RTC is funded from the following sources: 1) U.S. Treasury payments, borrowings and appropriations; 2) a contribution from the Federal Home Loan Banks through REFCORP; 3) amounts borrowed by REFCORP which is authorized to issue long term debt securities; 4) the issuance of debt obligations and guarantees as permitted by the Oversight Board; and 5) income earned on the assets of the RTC, proceeds from the sale of assets, and collections made on claims received by the RTC from receiverships, to the extent such amounts are needed for further resolution costs (as determined by the Oversight Board).

The Secretary of the Treasury has contributed capital of $18.8 billion to the RTC as of December 31, 1990. The RTC has also issued capital certificates of $24.2 billion to REFCORP as of December 31, 1990 (see Note 11). The RTC is also authorized to borrow from the Treasury an amount not to exceed in the aggregate $5.0 billion outstanding at any one time. As of December 31, 1990, the RTC had no borrowings outstanding from the Treasury.

The RTC's Office of Inspector General (OIG) received $10.8 million of appropriated funds for fiscal year 1991 from the U.S. Treasury to finance the activities of the Office of Inspector General.

In January 1991, the RTC issued capital certificates of $7.0 billion to REFCORP. During March 1991, the Resolution Trust Corporation Funding Act of 1991 authorized the Secretary of the Treasury to provide an additional $30 billion in capital to the RTC.

2. Summary of Significant Accounting Policies:

General. These statements do not include accountability for assets and liabilities of closed thrifts for which the RTC acts as receiver/liquidating agent or of thrifts in conservatorship for which the RTC acts as the managing agent.

Allowance for Losses on Advances and Loans. The RTC recognizes an estimated loss on advances and loans. The allowance for loss represents the difference between amounts advanced to conservatorships and expected repayments.

Allowance for Losses on Subrogated Claims. The RTC records as assets the amounts advanced for assisting and closing thrifts. An allowance for loss is established against subrogated claims representing the difference between the amounts advanced and the expected repayments. The allowance is based on the estimated cash recoveries from the assets of the assisted or failed thrift, net of estimated asset liquidation and overhead expenses, including interest costs.

Estimated Cost of Unresolved Cases. The RTC has recorded the estimated losses related to thrifts in conservatorship and those identified in the regulatory process as probable to fail.

Litigation Losses. The RTC recognizes an estimated loss for litigation against it in its Corporate, conservatorship and receivership capacities. The RTC Legal Division recommends these estimated losses on a case-by-case basis.

Escrowed Funds. The RTC holds funds in escrow equal to the amount of assets purchased by an assuming institution in a purchase and assumption transaction until such time a receivership withdraws the funds to buy back assets under put options or pay dividends, preferred secured claims, receivership expenses, or settlement costs. The RTC accrues interest on these funds on behalf of the receiverships.

Allocation of Common Expenses. The RTC shares certain administrative operating expenses with several funds of the Federal Deposit Insurance Corporation (FDIC) including the Bank Insurance Fund, the FSLIC Resolution Fund, and the Savings Association Insurance Fund. The administrative operating expenses include allocated personnel, administrative, and other overhead expenses.

OIG Appropriation. The RTC has reported OIG appropriations used to finance operating expenses as part of "Servicing and other revenue" in the Statement of Revenue, Expenses and Accumulated Deficit. Unobligated appropriations are reported in the equity section of the balance sheet as part of "Contributed capital".

Depreciation. The cost of furniture, fixtures, equipment and other fixed assets is expensed at time of acquisition, and is reported as administrative operating expenses. This policy is a departure from generally accepted accounting principles, however, the financial impact is not material to the RTC's financial statements.

Cash Equivalents. The RTC considers cash equivalents to be short-term, highly liquid investments with original maturities of three months or less. As of December 31, 1990, the RTC did not have any cash equivalents.

Comparative Financial Statements. Comparative financial statements are not presented since the figures shown for 1989 cover only a small portion of the year. To show comparative statements for periods of different lengths may be confusing and/or misleading. The RTC's December 31, 1989 financial statements were audited by GAO. (see GAO/AFMD-91-57, April 1991)

Related Party Transactions. The nature of the relationships and descriptions of the related party transactions are disclosed throughout the financial statements and related footnotes.

3. Net Advances and Loans (in thousands):

The RTC makes both secured advances and loans to its conservatorships and receiverships. The Corporation accrues interest on these advances and loans which is included in the Statement of Revenue, Expenses and Accumulated Deficit. The Corporation expects repayment of these advances and loans, including interest, before any subrogated claims are paid by receiverships. Rates used for accruing interest on advances and loans are based on an adjusted 13-week Treasury Bill rate and ranged between 6.97% and 8.50% during 1990.

	December 31, 1990
Secured advances to conservatorships	$ 9,051,139
Secured advances to receiverships	11,983,236
Loans to receiverships	1,693,208
Reimbursements due from receiverships and conservatorships	190,806
Accrued interest	449,140
Allowance for losses (Note 5)	(759,511)
	$ 22,608,018

Reimbursements due from receiverships and conservatorships for operating expenses represent amounts paid by the RTC on behalf of the receiverships and conservatorships for which repayment is expected in full. Interest is not accrued on these reimbursements.

4. *Net Subrogated Claims (in thousands):*

Subrogated claims from failures represent disbursements made by the RTC for depositor liabilities. The Corporation recognizes an estimated loss on these subrogated claims. The RTC accrues interest payable to receiverships on the balances of their escrowed funds. The rates used by the RTC to accrue interest are based upon the Chicago FHLB Overnight Deposit Rates. Monthly averages of interest rates during 1990 ranged between 7.54% and 8.39%.

	December 31, 1990
Subrogated claims	$ 102,284,412
Recovery on subrogated claims	(3,029,291)
Claims of depositors pending and unpaid	125,946
Escrowed funds	(32,033,010)
Allowance for losses (Note 5)	(41,809,360)
	$ 25,538,697

5. Analysis of Change in Allowance for Losses (in thousands):

	Balance, December 31, 1989	Provision for Losses	Reclassifications and Adjustments	Balance, December 31, 1990
Allowance for losses, subrogated claims	$ 5,398,914	$ (2,550,298)	$ 38,960,744	$ 41,809,360
Allowance for losses, advances and loans	-	-	759,511	759,511
Estimated cost of unresolved cases	94,669,000	992,700	(39,720,255)	55,941,445
Estimated losses from corporate litigation	83,719	74,465	-	158,184
	$100,151,633	$ (1,483,133)	$ -0-	$ 98,668,500

Reclassifications and adjustments represent amounts transferred from the liability for the estimated cost of unresolved cases to the allowance for losses on subrogated claims as a result of case resolutions. Amounts are also transferred from the liability for the estimated cost of unresolved cases to the allowance for losses on advances and loans for institutions in conservatorship.

6. Other Assets (in thousands):

The following are the components of other assets:

	December 31, 1990
Due from Government agencies	$ 3,504
Miscellaneous receivables	2,905
	$ 6,409

7. Liabilities Incurred from Assistance and Failures (in thousands):

The following are the major components from liabilities incurred from assistance and failures:

	December 31, 1990
Pending claims of depositors	$ 125,946
Due to insured depositors	364,951
	$ 490,897

8. Notes Payable:

Working capital was made available to the RTC during 1990 under an agreement between the RTC and the Federal Financing Bank. The working capital is available to fund the resolution of thrifts operating as conservatorships and for use in the RTC's high-cost funds replacement and emergency liquidity programs. During 1990, all outstanding notes matured at the end of each calendar quarter, at which time the then outstanding amounts were fully refinanced. The notes payable carry a floating rate of interest based upon the 13-week Treasury Bill rate and ranged between 7.19% and 8.32% during 1990. As of December 31, 1990, the RTC had $53.9 billion in borrowings and accrued interest outstanding from the Federal Financing Bank. These borrowings, approved by the Oversight Board, are within the limitations imposed under FIRREA.

9. Estimated Cost of Unresolved Cases:

The RTC has established at December 31, 1990, a liability of $55.9 billion for the anticipated costs of resolving 375 troubled institutions. These institutions were either in conservatorship at that date or identified by the Office of Thrift Supervision as Group IV (Watch List) institutions. The Group IV thrifts probably will require government assistance and are expected to be transferred to the RTC. The liability includes an estimate of operating losses at institutions between December 31, 1990 and the projected resolution date and thus is an estimate of the funds required to cover losses in the 375 institutions as of resolution. The liability recorded is the amount that is probable and reasonably estimable as of December 31, 1990.

The 1990 Estimated Cost of Unresolved Cases has declined considerably from the December 31, 1989 estimate of $94.7 billion. The primary reason for this decline is that 315 cases were resolved during 1990, leaving fewer unresolved cases at December 31, 1990.

In addition to those 375 thrifts for which a liability has been accrued, there are almost 400 other open institutions characterized by the Office of Thrift Supervision as troubled, but which "are not expected to require government assistance" (Group III institutions). Nonetheless, losses to the RTC from institutions in Group III are possible. If a substantial number of these institutions were to fail, the estimated cost to the RTC for case resolution might rise by as much as an additional $60 billion.

10. Estimated Losses from Corporate Litigation:

As of December 31, 1990, the RTC has been named in several thousand lawsuits while serving in its Corporate, conservatorship or receivership capacities. Currently, it is not possible to predict the outcome for all of the various actions. An allowance for loss totalling $158.2 million has been established as of December 31, 1990 for the 72 actions that management feels are probable to result in a significant loss. Additionally, the Corporation could possibly incur further losses from the other pending lawsuits and other yet unasserted claims.

11. Changes in Equity (in thousands):

Equity for the RTC as of December 31, 1990 is as follows:

	Contributed Capital	Capital Certificates	Accumulated Deficit	Total Equity
Balance, December 31, 1989	$ 18,800,000	$ 5,708,757	$ (99,927,739)	$ (75,418,982)
Net loss	-	-	(362,414)	(362,414)
OIG appropriation, unobligated	10,090	-	-	10,090
Issuance of capital certificates:				
01/30/90	-	5,017,221	-	5,017,221
04/20/90	-	3,495,438	-	3,495,438
07/19/90	-	4,999,757	-	4,999,757
10/16/90	-	5,026,681	-	5,026,681
Balance, December 31, 1990	**$ 18,810,090**	**$ 24,247,854**	**$ (100,290,153)**	**$ (57,232,209)**

12. OIG Expenditures:

Reductions to the RTC OIG appropriated fund for expenditures are recorded as "Servicing and other revenue". Accordingly, during 1990 the RTC OIG appropriated fund was reduced by $694,442 and recorded as "Servicing and other revenue". Further, disbursements of the OIG appropriated fund for expenditures are recorded as "Administrative operating expenses". As of December 31, 1990, the unobligated OIG appropriation balance was $10.1 million.

13. Pension Plan and Accrued Annual Leave:

The FDIC eligible employees assigned to the RTC are covered by the Civil Service Retirement System and the Federal Employees Retirement System. Matching employer contributions provided by the RTC for all eligible employees were approximately $5,654,979 for the year ending December 31, 1990.

Although the RTC contributes a portion of pension benefits for eligible employees and makes the necessary payroll withholdings from them, the RTC does not account for the assets of either of these retirement funds and does not have actuarial data with respect to accumulated plan benefits or the unfunded liability relative to its eligible employees. These amounts are reported by the U.S. Office of Personnel Management (OPM) and are not allocated to the individual employers. OPM also accounts for all health and life insurance programs for retired eligible employees.

The RTC's liability to employees for accrued annual leave is approximately $8,692,051 at December 31, 1990.

14. Commitments and Guarantees:

Affordable Housing Program:

As part of its Affordable Housing Program, RTC management has committed to expend up to $6 million to pay reasonable and customary commitment fees to various state and local housing authorities who will, in turn, provide financing to low and moderate income families. Under this program, the RTC works with state and local housing finance agencies to secure commitments of Mortgage Revenue Bond funds which will be lent to qualifying families to enable them to purchase properties from the RTC. At December 31, 1990, $2.3 million remains unexpended. No substantial recoveries are anticipated from the program.

Rental Expense:

The RTC is currently leasing office space at several locations to accommodate its staff. These offices include: (1) the Washington, D.C. Headquarter offices, (2) the four Regional offices, and (3) the fourteen Consolidated offices located throughout the various regions. The RTC's rental expense for 1990 totaled $16.6 million. The RTC's total contractual obligations under lease agreements for office space are approximately $156.0 million. The minimum yearly rental expense for all locations is as follows (in thousands):

1991	1992	1993	1994	1995	1996/Thereafter
$ 25,368	$ 23,817	$ 23,309	$ 20,375	$ 14,885	$ 48,296

All agreements contain escalation clauses which can result in adjustments to rental fees for future years.

Guarantees of RTC:

Asset Sale Guarantees:

The RTC is contingently liable with respect to guarantees, representations and warranties made for $9.9 billion in unpaid principal of loans sold for cash, exchanged for mortgaged-backed securities or under servicing right contracts which have been sold. However, a portion of the sales proceeds have been escrowed to honor any obligations that might arise from the guarantees, representations and warranties. No additional losses are anticipated from these arrangements.

Letters of Credit:

The RTC has adopted special policies for outstanding RTC conservatorship and receivership collateralized letters of credit. These policies enable the RTC to minimize the impact of its actions on capital markets. In most cases, these letters of credit are used to guarantee tax exempt bonds issued by state and local housing authorities or other public agencies to finance housing projects for low and moderate income individuals or families. As of December 31, 1990, the RTC has issued a commitment to honor approximately $2.1 billion of these letters of credit. The total amount that will ultimately be paid and the losses resulting from these letters of credit are not reasonably estimable at December 31, 1990.

15. Supplementary Information Relating to the Statement of Cash Flows (in thousands):

Reconciliation of net loss to net cash used by operating activities:

	For the year ended December 31, 1990
Net Loss:	$ (362,414)
Provision for losses	(1,483,133)
Interest expense financed through increased notes payable	857,737
Interest expense accrued on notes payable	929,779
Accrued escrow interest expense	1,395,438
Accrued interest due from advances and loans	(218,228)
Receipts from subrogated claims	1,879,579
Repayments of advances and loans	7,198,660
Increase in accounts payable, accrued liabilities and other	33,994
Disbursements for advances and loans	(19,037,050)
Disbursements for subrogated claims	(60,870,583)
Disbursements for reimbursable expenditures	(241,137)
Increase in other assets	(4,586)
Net cash used by operating activities	**$ (69,921,944)**

Noncash transactions incurred from thrift assistance and failures during 1990 (in thousands):

* $39,720,255 was reclassified to "Allowance for losses on subrogated claims" from "Estimated cost of unresolved cases" due to the resolution of 315 cases during 1990.
* $122,759 was reclassified to "Net subrogated claims - Depositor claims unpaid" from "Liabilities incurred from assistance and failures" also due to 1990 case resolutions.
* $857,737 of interest expenses were financed through increases in Notes payable.

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