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GAO

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General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-253861

January 24, 1994

The Honorable Andrew C. Hove, Jr.
Acting Chairman, Board of Directors
Federal Deposit Insurance Corporation

Dear Mr. Chairman:

In June 1993, we issued our opinions on the calendar year 1992 financial statements of the Bank Insurance Fund (BIF), FSLIC Resolution Fund (FRF), and Savings Association Insurance Fund (SAIF) and our opinion on the Federal Deposit Insurance Corporation's (FDIC) system of internal controls as of December 31, 1992, and have reported on FDIC's compliance with applicable laws and regulations for the three funds for the year ended December 31, 1992 (GAO/AIMD-93-5, June 30, 1993). We will also issue shortly a separate report describing material weaknesses and other reportable conditions in FDIC's system of internal controls identified during the course of our audits (GAO/AIMD-94-35).

The purpose of this letter is to report to you other matters identified during our audits regarding accounting procedures and internal controls which could be improved and to make suggestions for improvement. While these matters are not considered material in relation to the financial statements of the three funds, we believe they warrant management's attention. We have broken these matters down into three areas: (1) corporate operations (enclosure I), (2) consolidated office operations (enclosure II), and (3) serviced asset pool operations (enclosure III). The enclosures discuss these matters and include our suggestions for improvement.

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

We would appreciate receiving your comments and a description of the corrective actions FDIC plans to take to address these matters within 30 days from the date of this letter. We acknowledge the cooperation and assistance provided by FDIC officials and staff during our 1992 audits. If you have any questions or need assistance in addressing these matters, please contact me at (202) 512-9406 or Steve Sebastian, Assistant Director, at (202) 512-9521.

Sincerely yours,

Robert W. Gramling

Robert W. Gramling
Director, Corporate Financial Audits

Enclosures

FDIC CORPORATE OPERATIONS

As part of our calendar year 1992 audits, we tested accounting and other controls necessary to ensure that the assets of the funds administered by FDIC were safeguarded against loss from unauthorized use or disposition and that transactions were executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. We interviewed FDIC officials, reviewed FDIC policy, procedures, and accounting manuals and documented our understanding of the processes and relevant internal controls. We then designed procedures to test relevant controls for proper authorization, execution, and accounting and reporting of transactions. These tests covered reconciliations of various general ledger accounts on the Financial Information System (FIS) to determine if the account balances or account activity were being reconciled on a timely basis to supporting subsidiary records and whether such reconciliations were approved by appropriate supervisory personnel. We also tested the validity, accuracy, and proper recording of transactions processed during the year and performed analytical procedures. Discussed below are the internal control weaknesses we identified in performing these tests.

PERIODIC PHYSICAL INVENTORY COUNTS AND RECONCILIATIONS WERE NOT PERFORMED ON FRF STOCK CERTIFICATES

Periodic physical inventory counts and reconciliations between the inventory records and recorded amounts are necessary to ensure the reliability of recorded asset amounts and safeguarding of assets. We found that accountability and safeguarding of the FSLIC Resolution Fund's (FRF) stock certificates were impaired due to the lack of requirements to perform physical inventory counts and reconciliations between inventory records and amounts recorded.

FDIC maintains an inventory list of FRF's stock certificates. However, we found that the inventory list is inadequate for reconciling FRF's stock certificates to the recorded amounts. The list does not (1) provide a complete listing of FRF's stock certificates, (2) differentiate between stock certificates owned by FRF and those held by FRF as collateral, and (3) include recorded stock certificate amounts. Without maintaining accurate inventory lists and performing periodic physical inventory counts and prompt reconciliations, FDIC cannot be assured that FRF's financial information is accurate and that the stock certificates are properly safeguarded.

We suggest that FDIC update FRF's stock inventory list to (1) include all FRF stock certificates, (2) distinguish between FRF's stock certificates and stock certificates held as collateral, and (3) include recorded stock certificate amounts. In addition, we suggest that FDIC perform physical inventory counts on an annual basis, at a minimum, and reconcile FRF's stock certificate inventory list to the stock certificate amounts recorded on FIS. The physical inventory counts and reconciliations should be documented to allow audit verification of their propriety.

WIRE DISBURSEMENT RECONCILIATIONS WERE NOT PROMPTLY PERFORMED

FDIC requires that monthly wire disbursement control records be reconciled to statements from the U.S. Treasury. The wire disbursement reconciliation is to be completed 1 week after wire disbursement confirmations are received from the Treasury to ensure that all reconciling items are identified and promptly resolved. However, we found that the December 1992 wire disbursement reconciliations were not completed over 5 weeks after Treasury confirmations were received. Delays in performing this reconciliation increase the risk that errors or irregularities could not be detected and corrected.

We suggest that FDIC enforce its policy requiring that monthly wire disbursement reconciliations be completed 1 week after information is received from the Treasury.

SAIF EXIT FEES FROM INSURED DEPOSIT TRANSFERS WERE NOT RECORDED

Financial transactions must be promptly and accurately recorded if financial statements and related management reports are to maintain their relevance and value as an information resource on which to base decisions. FDIC is responsible for identifying and recording all SAIF exit fee transactions. These transactions include transfers of the insured deposits of a SAIF member institution that is in default or in danger of default to a BIF member. Although FDIC identified all such transfers, which were authorized by the Resolution Trust Corporation (RTC) and approved by FDIC during 1992, it did not record all of the related exit fee transactions in

SAIF's general ledger. The related exit fee transactions were not recorded because no individual was formally assigned the responsibility to ensure that, once the insured deposit transfer was identified, the related exit fee was recorded.

We suggest FDIC assign responsibility to appropriate personnel and establish a reconciliation procedure to ensure proper recording of exit fees arising from insured deposit transfers in SAIF's general ledger.

ADMINISTRATIVE EXPENSES WERE NOT ALWAYS CHARGED TO THE PROPER FUND

FDIC is responsible for administering and separately accounting for BIF, SAIF, and FRF. To provide a separate accounting for each fund, FDIC established accounting codes for charging and recording administrative expenses to the proper fund and/or receivership. FDIC Circular 4350.1 Accounting Codes for Expense Documents provides guidance regarding the proper use of accounting codes. The Circular assigns FDIC managers the responsibility for ensuring the proper coding of expense documents. Accounting technicians are responsible for entering the accounting codes charged on the expense documents into the subsidiary systems, which subsequently record the expenses in the general ledger. However, we found that certain administrative expenses, such as travel and procurement expenses, were not always charged to the proper fund and/or receivership during 1992.

While FDIC has authorization controls to ensure that the fund and/or receivership code charged on a travel voucher or payment authorization voucher is proper, FDIC does not have controls in place to ensure that the fund and/or receivership code on the vouchers is accurately entered by the accounting technician into the subsidiary systems. As a result, a fund and/or receivership could be erroneously charged for an expense incurred by another fund and/or receivership. In addition, since expenses incurred by a fund on behalf of a receivership are recoverable from the receivership, a fund may not be properly reimbursed from the receivership or the receivership may be overcharged for expenses if the wrong accounting code is charged.

We suggest that FDIC implement procedures to require routine comparisons of accounting codes on approved vouchers to information entered in subsidiary systems. These comparisons should be performed after the voucher has been approved because the accounting code may be changed or corrected as a result of the approval process. We also suggest that FDIC require the individual responsible for reviewing the fund codes to document this review on the payment form.

POLICIES AND PROCEDURES FOR CALCULATING RESERVES ON ASSETS FROM OPEN ASSISTANCE TRANSACTIONS DID NOT EXIST

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

In open assistance transactions, the FDIC acquires assets, such as notes receivable and stock certificates, as a result of providing assistance to troubled institutions in an effort to avert their failure. However, we found that FDIC did not have documented policies and procedures describing how recovery values for these assets were established during 1992. With no policy in place to guide the process of valuing acquired assets, FDIC has no assurance that estimated recovery values for these assets are developed using uniform and reasonable criteria.

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

CANCELLATION OF FRF OPEN ASSISTANCE TRANSACTIONS WERE NOT PROMPTLY RECORDED

Generally accepted accounting principles require that transactions be recorded in the accounting period in which they occur. However, we found that FDIC did not record the cancellation of FRF open assistance transactions in the proper accounting period.

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) created FRF to manage assets and pay obligations resulting from certain actions initiated by the Federal Savings and Loan Insurance Corporation before its dissolution. Certain of these assets and obligations were in the form of reciprocal certificates or notes. FDIC and several FSLIC-assisted thrifts subsequently agreed to cancel certain assistance-related assets and obligations. However, the associated transactions were not recorded by FDIC in time to prepare FRF's year-end financial statements for both 1991 and 1992. While the transaction amounts are immaterial to the financial statements as a whole, not recording the transactions promptly and within the proper accounting period misstated FRF's financial position.

We suggest that FDIC establish procedures to promptly identify the cancellation of obligations and related assets and record the appropriate transactions in the general ledger in the period in which the assistance is canceled.

SUPERVISORY REVIEWS OF FRF'S ESTIMATED LOSS RESERVES WERE NOT DOCUMENTED

FDIC's "General Guidelines/Methodology and Procedures (for) Preparation of Loss Reserves - Assistance Agreements" (General Guidelines) require that the Unit Chief or Assistant Regional Manager review and approve each FRF assistance agreement's loss reserve calculation. However, these General Guidelines do not require that the review and approval of FRF's loss reserve calculation be documented. Evidence of review and approval of such a complex calculation is an integral internal control to provide assurance that the loss reserve calculation is properly determined. We found that the review and approval of FRF's assistance agreement loss reserves calculation was not always documented.

On a quarterly basis, FDIC's Case Managers prepare estimates of assistance agreement loss reserves and submit them, along with an analysis of changes in loss reserves and the Case Manager's Transmittal Memorandum (Case Package), for approval. These loss reserves are reported as estimated liabilities for assistance agreements on FRF's Statement of Financial Position. However, the review and approval of the Case Package was not always documented during 1992 since the General Guidelines do not require that review and approval be documented. With no policy in place requiring documentation of the review and approval of the Case Package, there is no evidence that such reviews are performed, thus increasing the likelihood of miscalculations in FRF's estimated assistance agreement loss reserves and misstatements in FRF's financial statements.

We suggest that FDIC develop and implement a specific written policy to document the review and approval of each Case Package.

TRANSACTIONS WERE PROCESSED
WITHOUT WRITTEN AUTHORIZATION

A major objective of a system of internal controls is to provide assurance that all transactions are properly authorized to minimize the risk of waste, loss, unauthorized use, and misappropriation of assets. However, we found several transactions associated with failed financial institution resolution activity that were processed without proper authorization during 1992. Specifically, 24 transactions, or 7 percent of the 333 transactions we tested, were not properly authorized.

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

We suggest that FDIC ensure that all transactions are properly reviewed and authorized in accordance with management policy.

MISSTATEMENTS IN FRF'S CASH FLOW
STATEMENT WERE NOT DETECTED
DURING PREPARATION

Cash and noncash transactions must be accurately identified and appropriately disclosed if the Statements of Cash Flows are to accurately present the cash activities of BIF, SAIF, and FRF. During our testing of FRF's Statement of Cash Flows for the year ended December 31, 1992, we identified a misclassification between two line items. This misclassification caused offsetting misstatements in the "Net Unresolved Accounting Change" totals for two separate line items on the Statement of Cash Flows. The misclassification could have been detected if FDIC's formal procedures for preparing the Statement of Cash Flows required analysis of transactions identified as "Net Unresolved Accounting Change."

Currently, the cash flow statement preparation procedures are similar for all three funds administered by FDIC. While our audit procedures detected the misclassification in FRF's Statement of Cash Flows, continuation of the current FDIC procedures could allow material misclassifications on each Fund's Statement of Cash Flows to go undetected.

To detect misstatements without verifying each noncash transaction individually, we suggest FDIC develop formal procedures to analyze the aggregated transactions identified as "Net Unresolved Accounting Change" as part of preparing the Statements of Cash Flows.

LEASE INFORMATION LACKED SUPPORTING DOCUMENTATION AND ADEQUATE REVIEW

While not material to the financial statements of the three funds, leases, over their lives, represent significant expenses to FDIC. To ensure the reliability of recorded lease expense amounts and complete and accurate footnote disclosure in the financial statements, documentation should be readily available to clearly support the lease information reported in the financial statements. However, FDIC was unable to provide a complete listing of its leases or support its lease footnote disclosure in BIF's, SAIF's, and FRF's 1992 financial statements. In addition, we found that FDIC is not reviewing lease payment information in the Accounts Payable System (APS) or the related disclosure information.

FDIC does not provide central oversight for leases or have one set of standard policies and procedures for overseeing the administration of its leases. Instead, three separate divisions/offices handle the administration of leases: the Office of Corporate Services (OCS), the Division of Depositor and Asset Services (DAS),[1] and the Division of Supervision (DOS). The OCS administers its leases out of the Washington, D.C., office, while DAS and DOS delegate administration of their leases to the regional offices.

FDIC's Division of Finance (DOF) oversees APS and is responsible for authorizing the lease payments and compiling the information for the footnote disclosure. DOF relies on the various offices to ensure that APS contains updated lease information. However, since FDIC was unable to provide a complete listing of its leases, there is no assurance that the lease information on APS is complete or accurate. Since APS automatically generates monthly lease payments

[1]Effective October 4, 1993, FDIC's Division of Liquidation was reorganized into the Division of Depositor and Asset Services.

based on information in the system, incomplete information in APS could result in incomplete lease expenses being recorded for BIF, SAIF, and FRF, and could result in either underpayment or overpayment for leases.

We suggest that FDIC maintain a complete listing of all existing leases. In addition, we suggest that DOF obtain supporting documentation from the office or offices administering the leases and ensure that the lease information in APS and in the footnote disclosures for each fund is complete and accurate.

CONSOLIDATED OFFICE OPERATIONS

During our 1992 audits, we visited 11 of 17 FDIC consolidated offices to review the internal controls over cash receipts and disbursements, general ledger account reconciliations, and conversion of failed institution assets onto FIS and FDIC's Liquidation Asset Management Information System (LAMIS) for those banks closed in 1992. As part of our review, we tested reconciliations of various asset and liability accounts on FIS to determine if general ledger accounts were being reconciled on a timely basis to the appropriate subsidiary records, that necessary adjustments to FIS or the subsidiary records were accurately recorded, and that such reconciliations were approved by the appropriate supervisory personnel. In addition, we tested 165 cash receipts, 165 check disbursements, and 157 wire disbursements among the 11 offices we visited to verify that cash receipts and disbursements were valid and were recorded accurately in the general ledger and that cash disbursements were properly authorized. During our review, we noted weaknesses in general ledger account reconciliation and cash receipt processes. The internal control weaknesses noted in these areas are summarized below.

RECEIVERSHIP ACCOUNT RECONCILIATIONS WERE NOT PROMPTLY PERFORMED OR REVIEWED

FDIC's Regional Accounting Manual requires that consolidated offices maintain various subsidiary records or other documentation which support account balances in FIS. For example, the Liquidation Collection Account-Local is supported by bank statements, the Trustee for Owner account for rent deposits is supported by the property managers' financial statements, and various dividend and claim accounts on FIS are supported by a liability register. The Regional Accounting Manual requires that the subsidiary ledgers or other supporting documentation be reconciled to FIS on a periodic basis. The Manual also requires that receiverships' general ledger account reconciliations be reviewed by a supervisor. These reviews should be promptly performed to ensure that all reconciling items are identified and promptly resolved. However, the Manual does not (1) specify the time period for performing or reviewing the reconciliations and (2) require that supervisors document their review of the reconciliations.

We found that general ledger account reconciliations at one consolidated office did not reflect evidence of supervisory review and that the supervisory review of account reconciliations at two other offices was not performed promptly. At the office that did not reflect evidence of supervisory review, we found that the reconciliation tested was not reviewed for 3 months after the reconciliation was performed. Of the two locations we identified as having untimely supervisory review, the individual responsible for preparing certain account reconciliations at one of the offices did not submit several months of reconciliations for supervisory review until after we identified the condition during our audit. Without promptly preparing and reviewing account reconciliations, there is a greater likelihood that errors may not be detected and corrected in a timely manner, which could result in inaccurate financial records for consolidated offices.

We suggest that FDIC develop and implement specific written policy to have monthly reconciliations prepared and supervisory reviews performed and documented within 30 days after month-end.

FDIC LACKED CONSISTENT RECONCILIATION PROCEDURES

Standardized systems, reports, reconciliation procedures, and formats are necessary to ensure that all consolidated offices analyze general ledger accounts properly and consistently and that significant or unusual transactions, trends, and variances are brought to the attention of the appropriate level of management.

We found that several consolidated offices use different systems to support the subsidiary records to the general ledger. For example, the Addison Consolidated Office developed a system to support the Cash Collections-in-Process account. This system was also installed at the Houston, San Antonio, and South Brunswick Consolidated Offices. The Atlanta Consolidated Office, however, used a different subsidiary system. The O'Hare Consolidated Office, which in 1992 did not have a subsidiary system that aged items in the Collections-in-Process account, adopted Atlanta's subsidiary system in March 1993. Using different subsidiary systems increases the risk that significant inconsistencies exist in the format and content of data reported which could result in inconsistent or inappropriate conclusions based on the data.

We suggest that FDIC standardize the subsidiary systems used by consolidated offices and provide consistent reconciliation instructions and formats for all general ledger accounts.

CASH COLLECTIONS-IN-PROCESS ACCOUNTS WERE NOT ALWAYS RECONCILED OR CLEARED IN A TIMELY MANNER

FDIC's Regional Accounting Manual requires that all asset and liability accounts be supported by subsidiary records. FDIC also requires that all general ledger "in-process" accounts be monitored and any outstanding items be cleared in a timely manner. The accuracy of other receivership general ledger account balances depends on promptly clearing the Collections-in-Process accounts. Until "in-process" accounts are cleared, balances in related asset, liability, income, and expense accounts are not accurate and staff cannot determine whether FDIC or participants have received all amounts due.

While consolidated offices reconcile the preliminary balances in their Cash Collections-in-Process account on a daily basis, we found that offices which use the Work-in-Process (WIP) subsidiary system cannot reconcile the subsidiary ledger to the final month-end balance for the Cash Collections-in-Process account on FIS. This condition existed because the WIP system does not accept post-dated transactions, which can be entered on FIS. In addition, FDIC only requires that daily reconciliations of the account balance be performed to the subsidiary ledger and not to month-end aging reports.

We also found that the Cash Collections-in-Process account was not being cleared on a timely basis at the South Brunswick Consolidated Office. As of September 30, 1992, this office had a balance in the Cash Collections-in-Process account of $444 million. The balance of amounts greater than 30 days was $302 million, of which $71 million exceeded 90 days. The unapplied collections associated with two failed banks accounted for $263 million and $66 million of the balance exceeding 30 days and 90 days, respectively. According to FDIC personnel, outstanding balances in the account could not be cleared because the interim servicer associated with the two failed banks did not provide FDIC with sufficient detail to match corresponding debit and credit transactions. In July 1993, the interim servicing arrangement was terminated and servicing of these assets was assumed by FDIC personnel.

As a result of the above conditions, the final month-end balances of the Cash Collections-in-Process receivership accounts as reflected on FIS were not supported by the detailed subsidiary records. This limits the ability of FDIC and others to ensure the accuracy of these balances. Also, FDIC's inability to clear the South Brunswick Consolidated Office's Cash Collections-in-Process account in a timely manner precludes it from having assurance that other receivership general ledger accounts at the office are not misstated.

We suggest that FDIC reconcile the final month-end balances of the Cash Collections-in-Process account to its subsidiary records and aging reports, and clear "in-process" accounts within 30 days after month-end.

RECEIPTS WERE NOT ALWAYS DEPOSITED PROMPTLY OR PLACED ON HOLD LOG

FDIC's Regional Accounting Manual requires that all receipt items received before the depository deadline be deposited that day. Items not included in the daily deposit are placed on hold. Held items not included in the daily deposit are logged until they are released or deposited.

At two consolidated offices, we found that checks were deposited 1 to 2 days after their receipt. The Cashier's Unit received checks from the mail room in the morning for one site and in the afternoon for the other site. Checks received in the mail room after the pick-up time were processed the following day and deposited 2 days after receipt. These checks were not noted on a hold log from the date they were received to the time they were deposited. By not promptly depositing checks, FDIC cannot maximize the potential interest income on the collections. Also, by not recording undeposited checks on a hold log, FDIC cannot adequately safeguard these collections.

We suggest that FDIC enforce its procedures for promptly depositing checks or recording them on a hold log until they are deposited.

SERVICED ASSET POOL OPERATIONS

FDIC has contracted with third-party entities to service and liquidate 10 asset pools from various failed banks which include assets such as loans, other real estate owned, subsidiaries, and other assets. Seven of the pools are composed of assets from 26 receiverships with a recorded book value on FIS of $11.6 billion as of December 31, 1992. These seven pools are referred to as "on-book" serviced asset pools. The remaining three pools were purchased by the servicing entities with the option to sell the assets back to FDIC at the end of the 5-year term of the servicing agreements. These three pools are referred to as "off-book" serviced asset pools and are not recorded on FIS.

FDIC's Contractor Oversight and Monitoring Branch (COMB) is responsible for ensuring that the servicers properly manage, liquidate, and account for the assets within each pool, and DOF is responsible for ensuring that the transaction activity and asset balances are properly recorded on FIS. In addition to these serviced asset pools, FDIC has also contracted the servicing and liquidation of performing residential and commercial loans to another third party entity. Approximately $2.8 billion in loans from about 500 BIF and FRF receiverships were being serviced and liquidated by this servicing entity as of December 31, 1992. We identified the following internal control weaknesses in FDIC's serviced asset pool operations during our 1992 audits.

ASSESSMENT OF SERVICER INTERNAL AUDIT FINDINGS WERE NOT DOCUMENTED

The internal audit departments of the 10 asset pool servicers perform audits that are critical to the oversight of these pools. For such oversight to serve as an effective control, FDIC needs to evaluate the audit findings to determine what impact they have on ensuring the safeguarding of receivership assets and the completeness and accuracy of accounting and financial records.

During our audit, however, we found no evidence to indicate whether FDIC had considered the impact of the findings noted in the audit reports on FDIC's financial accounting and reporting process. Without documenting such consideration, there is a greater likelihood that follow-up procedures to reduce the exposure of incorrect accounting and reporting of financial information will be inadequate or untimely.

We suggest that FDIC document its conclusions as to whether audit findings would have a direct or indirect effect on amounts and controls related to the financial reporting process and whether each finding is considered significant and warrants additional follow-up before FDIC's financial reporting deadlines. The additional planned follow-up should be documented to provide assurance that the findings are resolved.

SAMPLING OF ASSETS WAS NOT REPRESENTATIVE OF ALL ASSETS IN SERVICED POOLS

FDIC performs file reviews of loan assets associated with the 10 serviced asset pools during scheduled semiannual site visitations. The purpose of the file reviews is to determine if procedures and controls are effective over each servicer's asset pools. To effectively assess a servicer's procedures and controls, the assets sampled should be representative of the entire population. We found, however, that FDIC's method of sampling pool assets for review did not ensure that all pool assets were subject to sampling.

FDIC divides each servicer's loan portfolio into three stratums or tiers. Tier one comprises those assets whose legal balances[2] exceed the minimum threshold and thus require oversight committee review and approval on a periodic basis. The pool assets with legal balances less than this threshold are divided between tier two and tier three in descending order. The threshold criteria between tier two and tier three is judgmentally determined by FDIC. FDIC changes the thresholds for tiers two and three as the threshold for oversight committee approval of assets changes.

On a rotational basis, FDIC specifically targets either tier two or tier three assets for sampling and review in its semiannual visitations. Visitations are not designed to specifically target tier one assets, although some of the tier one assets may be included in the semiannual visitations. Because FDIC rotates tiers two and three between visitations and because assets can move between tiers as a result of changes in tier thresholds, all pool

[2]Legal balance represents the amount of indebtedness or liability legally due and owed by an obligor, including principal and accrued and unpaid interest, late fees, attorneys' fees and expenses, taxes, insurance premiums, and similar charges, if any.

assets are not subject to sampling. Consequently, asset management and liquidation deficiencies existing for certain pool assets may not be identified, and the pervasiveness of deficiencies identified cannot be determined. In addition, FDIC does not track the size of each tier respective to the total asset pool in order to justify the tiers not targeted in each semiannual visitation. Therefore, the significance of the population not subject to testing is unknown.

We suggest that FDIC select a representative sample from all stratums or tiers at each semiannual visitation. FDIC should also track the population size, the stratum or tier size, the sample size and the results of the sample so that this information may be used to determine whether a significant or pervasive problem exists with the population as a whole.

FOLLOW-UP VISITATIONS BY FDIC ON SERVICED ASSET POOLS WERE NOT PERFORMED PROMPTLY

The credit visitation and the other real estate owned (OREO) visitation groups under COMB perform semiannual visitations to review loan and OREO assets, respectively, at each of the 10 serviced asset pools. These visitations identify weaknesses and areas of improvement in the servicers' management and liquidation strategies over the pool assets. After communicating the exceptions to the servicers and obtaining their responses, FDIC will schedule follow-up visits to verify that the appropriate action has been taken. Timely performance of follow-up visitations and tracking of all exceptions is necessary to assure FDIC that servicers are in compliance with FDIC policies and that corrective measures are being taken to address previous visitation findings.

Through reviews of visitation documentation and discussions with COMB personnel, we could not determine whether all significant exceptions noted in the visitation reports had been followed up on and appropriate actions taken. Many visitation reports indicated significant rates of exceptions in various critical areas, such as servicers not listing assets with brokers, servicers' asset and marketing managers not concurring with appraisal values, servicers not having a business plan for assets, and servicers having serious control weaknesses in their accounting systems. Some exception rates were as high as 50 percent. Additionally, some of the exceptions identified by the visitation groups are indicative of conditions that could impact both efficient and effective liquidation of the serviced assets and the calculation of recovery estimates for assets in liquidation.

Additionally, we found that only one credit visitation follow-up began within 3 months of the completion of the prior visitation's fieldwork. Follow-up on three credit visitation reviews did not occur for over 6 months after the visitation group's fieldwork had ended. Also, follow-up on the January 1992 OREO visitation for one servicer was deferred from March and June 1992 to September 1992, at which time the visitation group determined that many of the exceptions reported in the January 1992, visitation remained uncorrected. Additional follow-up was scheduled for January 1993, but was postponed again to allow the servicer an additional 90 days to implement corrective action. Finally, follow-up on another servicer's August 1992 OREO visitation was postponed until the first semiannual visit in 1993 because the servicer moved offices during this period.

We suggest that FDIC ensure that servicers implement corrective actions to enable the visitation groups to perform follow-up procedures for significant findings within 90 days of completion of fieldwork. In addition, we suggest that FDIC ensure that visitation groups perform follow-up procedures for significant findings within 90 days of fieldwork and that the groups adequately document exceptions and their ultimate disposition.

OREO VISITATION REPORTS WERE NOT APPROVED PROMPTLY

FDIC's OREO visitation groups visit each servicer on a periodic basis to review OREO assets within the servicer's portfolio. These visitations include reviews of the asset marketing strategies and the asset management practices employed by the servicer. The visitation group prepares a report which summarizes the findings from each review. This report is submitted to the servicer's oversight committee which, upon its review and approval, forwards the report to the servicer for response and corrective action. If the oversight committees do not promptly approve the reports, FDIC management cannot ensure that corrective action is being taken.

We found that the OREO visitation reports were not consistently approved in a timely manner by the oversight committees during 1992. Of the 25 reports issued in 1992, the time between fieldwork completion and report approval was 4 months for two reports, 5 months for two reports, and 6 months for one report. Delays in oversight committee approval can cause delays in corrective action by servicers and can impact the ability of FDIC's visitation group to perform effective follow-up reviews. We found that follow-up generally occurred 4 to 11 months after original fieldwork completion in 1992.

We suggest that FDIC require servicer oversight committees to review and approve OREO visitation reports within 30 days after fieldwork to facilitate prompt resolution of exceptions and follow-up visitations.

CONTROLS OVER SUBSIDIARY ACCOUNTING ON SERVICED ASSET POOLS WERE INADEQUATE

FDIC accounts for subsidiaries of failed institutions on the FIS receivership general ledger using the equity method of accounting. Under the equity method of accounting, investors should adjust the carrying amount of the investment to recognize its share of earnings or losses. However, the investors should not provide for additional losses when the investment falls below zero unless the investor is committed to provide further financial support to the investee. Therefore, the balance in the FIS account which reflects FDIC's investment in subsidiaries should not fall below zero. This method of accounting is used primarily to assure accurate reporting of the legal balances of FDIC's assets and liabilities. Additionally, the asset servicing agreements between FDIC and the contracted asset servicers require compliance with receivership accounting policies and specifically state that the adjusted pool value with respect to any pool asset should not be less than zero.

In testing the reconciliations for one of the serviced asset pools, we found that although the investment in subsidiary balance on FIS was properly stated at $1, the pool records maintained by the servicer improperly reflected the negative equity of the subsidiaries. The accounting of negative operating results for subsidiaries gives the appearance that the insurance funds are liable for the operating losses of the subsidiaries.

We also found that advances to subsidiaries were reflected on FIS as "Principal Disbursements" for commercial loans. Although policy regarding subsidiary advances had not been finalized at the time of our fieldwork, recording subsidiary advances as principal disbursements on commercial loans impairs FDIC's ability to determine the amount of funds advanced between commercial loans and subsidiaries. Since the subsidiaries have a separate plan of liquidation from other receivership assets, it is important that the advances to these subsidiaries be clearly identifiable as it could impact liquidation decisions.

We suggest that FDIC require the servicer to maintain any investment in subsidiaries' balances with negative equity at $1 to ensure accurate accounting of the legal balance of FDIC's assets and liabilities on the servicer's records. Additionally, we suggest that FDIC establish a separate account or identification code on the FIS receivership general ledger for receivership advances to subsidiaries so they can be uniquely identified.

RECONCILIATION OF SERVICED ASSET POOLS WAS PERFORMED INCONSISTENTLY

Requiring standardized reconciliation and report formats would assure FDIC that servicer asset pool records are reconciled consistently to the FIS receivership general ledger and ensure both consistency of data used in the reconciliations and a better understanding of the information reported.

However, we found that FDIC requires no standardization in the reconciliations of the servicers' pool balances to FIS. Inconsistency exists in the structure of the reconciliations as well as the data to which the pools are reconciled. In reconciling pool balances, the FIS balances for some pools are reconciled to the servicers' pool balances obtained from a manually prepared roll-forward schedule instead of the asset balances from the servicers' general ledger. These roll-forward schedules account for beginning and ending net book value of the pool each month plus monthly activity in the pool. Some of the asset roll-forward schedules reflect interest and fee income as items deducted from the pool's net book value, further complicating the reconciliation process.

Without appropriate consistency in the reconciliations of the serviced asset pools, FDIC's ability to understand these reconciliations is diminished, limiting its ability to ensure the safeguarding of receivership assets. Also, by allowing some servicers to report interest and fee income as deductions to the net book value of pool assets, the adequacy of the servicers' accounting and understanding of the asset pools is questionable.

We suggest that FDIC adopt consistent reporting formats for the reconciliation of servicers' pool records to FIS and adopt consistent guidance for the reporting of asset collections.

SERVICERS' CASH ACCOUNT RECONCILIATIONS WERE NOT REVIEWED BY FDIC

Reviewing the servicers' reconciliations between their cash accounts and the servicers' reported cash balances as reflected in their general ledger would assure FDIC that the reported cash balances are accurate and that servicers are promptly remitting cash collections. However, we found that FDIC does not review the cash account reconciliations for the seven on-book asset pools to ensure that there are no significant unreconciled or unresolved differences between the servicers' general ledger cash balance and the servicers' cash balance per the bank statement. Without such reviews, FDIC may be unaware of inadequate servicer controls over cash and may not be receiving all cash collections resulting from the management and liquidation of pool assets.

We suggest that FDIC review the servicers' bank reconciliations on a monthly basis for accuracy and completeness to ensure that no unresolved differences exist between the servicers' reported cash balances and those reflected on the servicers' bank statements.

SERVICER ALLOCATION REPORTS WERE NOT VERIFIED TO SERVICERS' SUBSIDIARIES

Verification of collection allocation reports provided by the servicers to source documents would assure FDIC that collections remitted by servicers are properly applied to the appropriate asset accounts in the FIS receivership general ledger.

The collection allocation reports instruct FDIC how to apply servicer collections from the management and liquidation of pool assets between principal, interest, and other income and are the source for journal entries posted to the FIS receivership general ledger. We found, however, that FDIC does not verify these reports back to the servicers' loan and OREO systems. By not verifying the collection allocation reports back to the servicers' systems, errors in these reports may go undetected and result in erroneous entries in FIS. Without such verification, FDIC also may be unaware of potential problems in the servicers' systems, which could result in incorrect asset balances in FIS and inadequate safeguarding of receivership assets by servicers and FDIC.

We suggest that FDIC verify servicer collection allocation reports to the servicers' loan and OREO systems to ensure their completeness and accuracy.

IMPROPER ADJUSTMENTS WERE MADE TO FIS FOR ONE SERVICED ASSET POOL

FDIC requires that all adjustments be adequately supported and reviewed before recording entries to FIS. We found, however, that adjustments to FIS to account for the activity of one servicing entity were not always supported prior to being recorded or adequately investigated to ensure that such entries were appropriate.

During September 1992, FDIC began accounting for collections and expenditures of one of the on-book serviced asset pools on a daily basis instead of the monthly basis previously employed. This process required FDIC to replicate on FIS the cash collection and remittance transactions recorded on the servicer's general ledger. This activity was recorded in the FIS "Liquidation Collection Account-Local", which represents a local bank account. In October 1992, FDIC recorded an adjustment of $11.5 million to FIS to "force" the account balance to equal an expected FIS balance as of September 30, 1992. Before recording the adjustment, no investigation had been performed to determine why the adjustment was needed. According to FDIC personnel, this adjustment was a result of the accountant attempting to bring FIS in balance with what was believed to be the appropriate amount. In the following month, FDIC determined that the entry was not necessary and a reversing entry was recorded to FIS. Proposing and posting such an adjustment without proper investigation of the underlying cause of the outage may mask the actual problems causing the outage and further perpetuate reporting errors.

We suggest that FDIC personnel properly investigate and document outages between servicer records and FIS prior to proposing any adjustment. Additionally, we suggest that supervisory personnel document their review of the proposed adjustments.

REMITTANCE PROCEDURES FOR ONE SERVICED ASSET POOL WERE INADEQUATE

FDIC has established centralized depository accounts at two banks into which the daily collections can be transferred from the FDIC consolidated sites and from the on-book servicers. We believe the centralization of available cash balances allows FDIC to have stronger safeguarding controls over the cash and to more effectively manage funds.

However, during 1992, one of the large on-book servicers remitted collections from asset liquidation activity to a local non-interest bearing account controlled by FDIC at NationsBank of Texas (NationsBank), the parent company of the servicer, instead of directly wiring remittances to FDIC's centralized bank account at Mellon Bank of Chicago (Mellon). This resulted in an additional 2-day lag between the date FDIC received the remittance in the NationsBank account and the date these funds were wired to Mellon and the loss of interest income on the average outstanding balance. As of September 30, 1992, the balance in the NationsBank account was $11.3 million.

We suggest that FDIC require servicers to remit all funds directly to the appropriate centralized bank account. According to FDIC personnel, the NationsBank accounts will be closed and remittances will be directly wired to the centralized cash account with Federal Home Loan Bank (FHLB) of Chicago pending conversion of all Mellon accounts to FHLB.

CONTROLS AT PERFORMING LOAN SERVICER WERE INADEQUATE TO ENSURE COMPLETE AND ACCURATE REPORTING OF GROSS CASH RECOVERY VALUES

FDIC provides accounting oversight to its servicer of performing commercial and residential loans through its Mortgage Oversight Servicing Section (MOSS) and provides credit oversight through its National Mortgage Sales and Servicing (NMSS) unit. MOSS is responsible for reconciling the asset book values on FIS and LAMIS to the servicer's loan system. NMSS is responsible for inputting gross cash recovery estimates (GCR) reported by the performing loan servicer for the loans it services into LAMIS. The GCR report prepared by the servicer provides the principal balance of serviced assets along with their respective GCRs. To provide assurance to NMSS as to the completeness of the GCR report, the principal balances on the GCR report from the performing loan servicer need to be reconciled to the balances used on the MOSS reconciliation of the servicer pool balances to FIS and LAMIS.

We found, however, that NMSS does not reconcile the principal balance on the GCR report to the principal balance used by MOSS in its reconciliation of the servicer's loan system to FIS and LAMIS.

In addition, NMSS does not establish a control total for GCRs before inputting them into LAMIS. Finally, MOSS does not communicate to NMSS the amount or nature of differences it identifies in the reconciliation of the servicer's loan system to FIS and LAMIS so that NMSS can make a determination as to whether the differences in asset book values has an impact on GCR estimates.

We investigated large differences in reported asset book values between FIS and LAMIS as of September 30, 1992, for assets maintained by the performing loan servicer to determine whether these differences were indicative of incomplete or inaccurate GCRs. We determined that the September 1992 GCR estimate of $134 million for one receivership had not been recorded in LAMIS. This error could have been detected had a control total been established before inputting GCRs into LAMIS or had MOSS communicated to NMSS the difference in reported asset book values between FIS and LAMIS. Other cutoff errors may occur if principal balances reported on the GCR report are not reconciled to the principal balances used by MOSS in the reconciliation of the servicer's loan system to FIS and LAMIS.

We suggest that (1) NMSS verify the principal balances on the GCR report to the principal balances used by MOSS in the reconciliation process, (2) MOSS communicate to NMSS any detected reconciliation differences between the servicer, FIS, and LAMIS, and (3) NMSS generate a control total for the GCRs prior to their input into LAMIS.

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