United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Oversight of Government Management, Committee on Governmental Affairs, United States Senate

For Release on Delivery
Expected at
2:30 p.m.
Tuesday,
November 9, 1993

FDIC

Liquidation of Failed Bank Assets at Risk Due to Inadequate Manual and Automated Processes

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GAO/T-AIMD-94-56

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today at the Subcommittee's request to discuss two of our reports on automated systems used by the Federal Deposit Insurance Corporation (FDIC) to carry out the liquidation of failed bank assets. In August 1991, we reported[1] that basic internal controls were not in place to ensure that manual and computerized asset files reflected the actual status of assets at FDIC's Denver Consolidated Office. In that report, we concluded that fundamental controls over manual and automated records had broken down almost completely. As a result, assets were grossly overvalued and cash receipts were unaccounted for. In February 1993, we reported[2] that because of weaknesses in FDIC's manual and automated asset management processes at three FDIC consolidated offices, FDIC did not maximize cash recovery on failed bank assets. For example, FDIC did not collect from delinquent borrowers $1.4 million in income generated by collateral on the borrowers' loans.

The following outlines our findings in these two reports.

AUGUST 1991 REPORT

In 1991, we reviewed a private investor's allegations that loans he had purchased from FDIC were inaccurately represented. At our request, he provided us with 25 loans that he believed best represented his concerns. We found serious errors in FDIC's manual loan files and automated system for 23 of these loans. We also found that basic internal controls--such as those to account for cash receipts--were not in place to ensure that FDIC's manual and automated records were properly updated to reflect the actual status of loans. Consequently, the information provided to potential investors--i.e., those who may be interested in buying the loans from FDIC--on 23 loans was inaccurately represented.

Specifically, as a result of the manual and automated records not being properly updated, the following facts were not made known to potential investors

-- 5 of the 23 loans had been fully paid at least 2 years before the sale,
-- documentation for 6 loans showed collateral that did not exist,
-- documentation for 4 loans showed that FDIC owned the entire loan when portions were actually owned by other financial institutions, and

[1]FDIC: Loan Sales Jeopardized by Systems and Other Internal Control Problems (GAO/IMTEC-91-61, Aug. 21, 1991).

[2]Asset Management System: Liquidation of Failed Bank Assets Not Adequately Supported by FDIC System (GAO/IMTEC-93-8, Feb. 3, 1993).

-- 8 loans involved borrowers either in bankruptcy or having outstanding court judgements against them for nonpayment of the loans.

These serious errors raised concerns as to whether the Denver office could effectively implement an important FDIC mission to sell assets. We also reported that since FDIC's Inspector General found similar problems at eight consolidated offices in 1990 and 1991, FDIC's asset liquidation program could be in jeopardy because reliable asset information was not available for the efficient and effective disposal of assets.

We emphasized the need for immediate action and made a number of recommendations designed to correct the problems in Denver and determine the extent of the problems throughout FDIC. Specifically we recommended that action be taken at the Denver office to

-- properly account for cash receipts in the manual and automated loan records,
-- correct manual and automated loan records,
-- strengthen procedures to maintain accurate and current loan records, and
-- periodically review loan records to verify the status of the loans.

We also recommended that FDIC take steps to ensure that the internal control weaknesses discussed in our report did not exist at other FDIC offices.

FDIC generally agreed with our findings and recommendations, but said that the problems at its Denver office were isolated and were being corrected, and steps had been taken to resolve similar problems reported by its Office of the Inspector General. We responded that FDIC needed to find out whether its actions would adequately resolve the problems and whether similar problems existed in its other consolidated offices.

FEBRUARY 1993 REPORT

Our February 1993 report showed that FDIC's manual and automated systems used to manage its liquidation program continued to have major problems. Because FDIC established operating requirements for managing and liquidating failed bank assets to maximize cash recovery, we focused our review on assessing whether (1) these operating requirements were being followed for a sample of 90 loan and 45 real estate assets being managed at three FDIC consolidated offices, and (2) records maintained in FDIC's Liquidation Asset Management Information System (LAMIS) and manual asset files provided the information needed to carry out and oversee liquidation activities.

Our February 1993 report cited several serious weaknesses in FDIC's manual and computer processes. As a result of these weaknesses, FDIC's operating procedures were not being adequately followed in four critical areas. Of the 90 loans reviewed, FDIC did not

-- demand payments from delinquent borrowers on 57 of 59 delinquent loans,
-- pursue foreclosure or seizure action in a timely manner on 35 of 51 delinquent loans for which this action was applicable,
-- analyze the financial condition of borrowers on 36 loans, and
-- protect its interest in the collateral securing 40 loans, thus losing revenue being generated by the collateral and, in one case, the collateral itself.

For example, FDIC did not (1) collect $1.4 million in income being produced from collateral securing 13 delinquent loans, and (2) ensure that property taxes were paid on loan collateral valued at $79,000, resulting in the local taxing authority selling the collateral for $2,400. Account officers who managed these assets explained that their high workload and inadequate computer support contributed to these problems. In addition, we found that FDIC's LAMIS system was not designed to help manage assets in three of these four areas.

For the 45 real estate assets we reviewed, we identified similar manual and computer weaknesses in three critical areas: property management, real estate budgets, and marketing.

In the property management area, FDIC did not

-- inspect 21 properties, as required,
-- pay taxes promptly on 27 properties, or
-- annually review contractor records on 9 properties, as required.

In one of the properties FDIC failed to inspect, FDIC lost revenue because unauthorized tenants had occupied the building for 2 years. For 19 properties, FDIC was assessed $95,500 in penalties and interest because local property taxes either had not been paid on time or had not been paid at all.

In the real estate budgeting and marketing areas, FDIC exceeded real estate management budgets for 16 properties and did not prepare required appraisals and marketing plans. Account officers and managers told us that the computer system was too difficult to use to carry out FDIC's operating requirements for real estate.

We also found that (1) the computer system was not designed to provide all the information needed to carry out and oversee operational requirements for real estate (e.g., tracking expenses for individual assets) and (2) much of the information in the system was inaccurate or incomplete. About 37 percent of the computerized records for the 135 assets we reviewed had an error in at least one of three basic data elements needed to manage and sell assets: asset type, asset status, or other asset owners. FDIC's Inspector General found similar problems in a March 1992 report. Our computerized analysis of FDIC's 131,000 automated asset records showed that 29 percent of the 30,000 real estate loans on the system did not have information about the loans' collateral.

We concluded that these problems existed because FDIC had not adequately designed systems to support its operating and oversight requirements for asset liquidation. We recommended that FDIC establish a systems design process to effectively address asset liquidation requirements.

FDIC has taken steps to improve its manual and computerized asset liquidation processes. For example, FDIC has

-- implemented a data validation program that requires a monthly review and certification of selected asset information,
-- established a separate Division of Information Resources Management to help coordinate and improve the way requirements are determined and addressed within FDIC, and
-- developed plans to comprehensively evaluate its asset information requirements.

These are steps in the right direction. However, it remains to be seen whether these actions will be properly implemented to solve the problems identified in our two reports.

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Mr. Chairman, this concludes my statement. I will be happy to answer any questions you or other Members of the Subcommittee may have.

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