



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

Accounting and Information  
Management Division

B-262036

July 29, 1996

The Honorable Ricki Helfer  
Chairman, Board of Directors  
Federal Deposit Insurance Corporation

Dear Madam Chairman:

On July 2, 1996, we issued our opinions on the Resolution Trust Corporation's (RTC) 1995 financial statements and management's assertions regarding the effectiveness of its system of internal controls as of December 31, 1995. We also reported on RTC's compliance with selected laws and regulations during 1995 (GAO/AIMD-96-123, July 2, 1996).

The purpose of this letter is to advise you of matters identified during the audit relating to errors in the accumulation of reliable and relevant data used for accounting estimates presented in RTC's financial statements and to suggest related improvements to strengthen those internal controls weaknesses. These matters include the need to properly value the recovery of receivership securities, to exclude expired contracts from the representation and warranty estimate, and to properly verify data and formulas used to estimate recoveries of securitization reserves.

Although these matters were not material in relation to the financial statements, we believe that they warrant the attention of management because they address internal control weaknesses that, if not corrected, could continue under FDIC management. We provided FDIC officials with a draft of this letter and discussed the matter addressed in it with them. The FDIC officials agreed with our findings and suggestions.

ESTIMATED RECOVERIES FOR RECEIVERSHIP  
SECURITIES NOT PROPERLY VALUED

RTC's financial statements reflect an allowance for loss against subrogated claims that is partly based on the valuation of the assets held for sale by RTC's

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receiverships. These assets included debt and equity securities held by receiverships at December 31, 1995.

In order to estimate recoveries on these RTC securities at December 31, 1995, FDIC used average recovery rates developed when RTC's December 31, 1994, securities universe was valued in mid-1995. In applying these average rates to the RTC securities at December 31, 1995, FDIC did not consider changes in the securities portfolio between December 1994 and December 1995.

To develop reliable estimates of recovery values for securities, we suggest that FDIC review its policy to ensure that receivership securities are properly valued based on current information.

EXPIRED CONTRACTS INCLUDED IN ESTIMATE  
FOR REPRESENTATIONS AND WARRANTIES

RTC's financial statements include an estimate for future representation and warranty costs on assets sold as part of the allowance for loss against subrogated claims. In order to calculate this estimate, information on the representation and warranty contracts is needed from the Asset Claims Administration's (WRAPS) database.

During our audit, we found that nonguaranteed contracts with expired indemnification periods were included in the WRAPS database used to calculate the estimated costs and that such contracts were not required to be deleted from WRAPS. The total amount of the 1995 estimate of the liability for nonguaranteed contracts was approximately \$70 million, and represented 9 percent of the total representation and warranty cost estimate of \$810,181,865. As a result, the estimated costs for representations and warranties could be overstated.

We suggest that FDIC maintain a WRAPS database that identifies those contracts for which the indemnification period has expired and/or is expected to expire at year-end and that these contracts be excluded from the representation and warranty cost estimate.

DATA INPUT ERRORS IN ESTIMATION  
OF SECURITIZATION RESERVES

RTC's process for estimating future recoveries of securitization reserves used data from several sources, including calculated inputs. The process also included

procedures for verifying the data used in the estimate. During the period audited, one accountant performed data input, and another accountant reviewed the inputs.

However, we found errors in the data used for calculating inputs for the estimates. Although the calculated inputs were verified back to the source documents, the data used for the calculations were not verified by an independent review. We also that some formulas used to calculate the estimate were incorrectly updated.

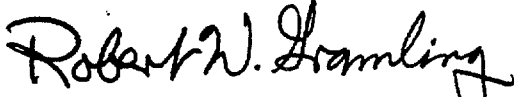
The number of formulas involved and the ongoing need to modify formulas in the estimation process could result in an increased risk that future errors will not be identified and corrected in a timely manner. We suggest that FDIC management review the data verification process to ensure that it includes (1) recomputation of data input formulas when appropriate and (2) verification of data used to calculate inputs to the formulas.

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We are sending copies of this letter to the Chairman and the members of the Audit Committee, Federal Deposit Insurance Corporation; the Chief Financial Officer, Federal Deposit Insurance Corporation; and the Inspector General, Federal Deposit Insurance Corporation.

We would appreciate receiving your comments as well as a description and status of your planned corrective actions within 30 days from the date of this letter. We acknowledge the cooperation and assistance the RTC and FDIC management and staff provided during the 1995 audit. If you have any questions or need assistance in addressing these matters, please contact me at (202) 512-9406, or John Reilly, Assistant Director, at (202) 512-9517.

Sincerely yours,



Robert W. Gramling, Director  
Corporate Audits and Standards

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