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Report to the Congress

June 1992

FINANCIAL AUDIT

Savings Association Insurance Fund's 1991 and 1990 Financial Statements

146966

GAO

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

Comptroller General
of the United States

B-114893

June 30, 1992

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

This report presents our opinion on the financial statements of the Savings Association Insurance Fund (SAIF) for the years ended December 31, 1991 and 1990. These financial statements are the responsibility of the Federal Deposit Insurance Corporation (FDIC), SAIF's administrator. SAIF's financial statements present fairly, in all material respects, its financial position and the results of its operations and cash flows for the years then ended in conformity with generally accepted accounting principles. Our reports on FDIC's internal control structure and on its compliance with laws and regulations as they relate to SAIF are also presented. 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.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), created SAIF to provide deposit insurance to all federally-insured savings associations and to thrift deposits acquired by banks. Our report discusses SAIF's resolution responsibility, its financial condition, and its exposure to insurance losses from the failure of thrifts and banks holding SAIF-insured deposits. In addition, we discuss factors that could affect the adequacy of SAIF's funding sources.

Our report on SAIF's internal control structure discusses two material internal control weaknesses regarding (1) FDIC's process for estimating SAIF's potential insurance losses and (2) FDIC's time and attendance reporting, which is FDIC's principal means of determining payroll expenses for each of its funds.

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 Secretary of the Treasury; the Director of the Office of Management and Budget; and the Director of the Office of Thrift Supervision.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

Contents

Abbreviations

BIF	Bank Insurance Fund
FDI Act	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FICO	Financing Corporation
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
FRF	FSLIC Resolution Fund
FSLIC	Federal Savings and Loan Insurance Corporation
OTS	Office of Thrift Supervision
REFCORP	Resolution Funding Corporation
RTC	Resolution Trust Corporation
SAIF	Savings Association Insurance Fund

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To the Board of Directors
Federal Deposit Insurance Corporation

We have audited the accompanying statements of financial position of the Savings Association Insurance Fund (SAIF) as of December 31, 1991 and 1990, and the related statements of income and fund balance and the statements of cash flows for the years then ended. These financial statements are the responsibility of the Federal Deposit Insurance Corporation (FDIC), SAIF's administrator. Our responsibility is to express an opinion on these financial statements based on our audit. In addition, we are reporting on our consideration of FDIC's internal control structure and its compliance with laws and regulations as they relate to SAIF.

We conducted our audits 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SAIF as of December 31, 1991 and 1990, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), created SAIF to provide deposit insurance to all federally-insured savings associations (thrifts) and to thrift deposits acquired by banks, commonly referred to as "Oakar banks."

Through September 30, 1993, the Resolution Trust Corporation (RTC) and SAIF share responsibility for resolution costs associated with failed thrifts. RTC is responsible for resolution costs of any federally-insured thrift that was previously insured by the Federal Savings and Loan Insurance Corporation (FSLIC) and placed into conservatorship or receivership from January 1, 1989, through September 30, 1993. SAIF is responsible for resolution costs of any federally-insured thrift that was not previously insured by FSLIC. After September 30, 1993, SAIF will assume the resolution costs of all SAIF-insured thrifts, including thrifts that were previously insured by FSLIC.[1]

In addition, SAIF is currently responsible for a portion of losses incurred in the resolution of failed Oakar banks. Pursuant to section 5(d)(3) of the Federal Deposit Insurance Act (FDI Act), federally-insured banks can engage in specified transactions in which they acquire thrift deposits without changing insurance coverage for the acquired deposits. Such acquired deposits continue to be insured by SAIF and assessed at SAIF's assessment rate. Losses resulting from the failure of Oakar banks are allocated between SAIF and the Bank Insurance Fund (BIF) in proportion to the bank's SAIF-insured and BIF-insured deposits.

The following sections provide supplementary comments relating to SAIF's financial condition, SAIF's exposure to thrift and bank failures, and factors that could affect the adequacy of SAIF's funding sources.

SAIF's Financial Condition

As of December 31, 1991, SAIF reported an $87 million fund balance. As discussed in note 5 to the financial statements, SAIF's 1991 financial statements reflect a $21 million loss attributable to the September 1991 failure of Southeast Bank, an Oakar bank. This expense represents SAIF's allocated share of the estimated cost FDIC incurred for Southeast's resolution. During 1991, Southeast Bank was the only Oakar bank closed by federal regulators.

As discussed in note 11 to the financial statements, FDIC recently examined its treatment of assessments paid by Oakar banks on SAIF-insured deposits. Since the enactment of FIRREA in 1989, FDIC had treated Oakar assessments like assessments paid by SAIF members and, accordingly, had distributed the Oakar assessments along with assessments from SAIF members to the

[1]Any thrift requiring resolution after September 30, 1993, which had previously been under RTC conservatorship or receivership may be returned to RTC for resolution, in accordance with the provisions of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991.

Financing Corporation (FICO), Resolution Funding Corporation (REFCORP), and FSLIC Resolution Fund (FRF), under applicable statutory provisions.[2] FDIC concluded that Oakar assessments could be retained by SAIF rather than distributed among FICO, REFCORP, and FRF, and has applied this determination retroactively to FIRREA's enactment. This retroactive treatment results in SAIF reporting revenues of $91 million and $17 million in 1991 and 1990, respectively, and recognizing a receivable in 1991 from FRF of $108 million for the Oakar assessments originally paid to FRF.[3] Based on our review of the applicable statutory provisions and information FDIC provided, we believe its conclusion and treatment of Oakar assessments are reasonable.

SAIF's Future Viability Is Uncertain

The losses SAIF incurs from future thrift and Oakar bank failures and the adequacy of its funding to carry out its responsibilities in light of these losses will affect SAIF's ability to provide insurance protection to depositors and remain viable.

SAIF's Continuing Exposure to Losses From Thrift Failures

Private sector thrifts (those not under the government's control) ended 1991 with a $2 billion profit, making 1991 the thrift industry's first profitable year in 5 years. The Office of Thrift Supervision (OTS), the industry's federal regulator, attributes this profit to (1) the decline in interest rates, resulting in a favorable spread between the rates of interest thrifts earn and the rates thrifts must pay to borrow funds, and (2) RTC's resolution actions, which eliminated a total of 584 unprofitable thrifts between August 9, 1989, and December 31, 1991.

While the thrift industry's financial condition improved during 1991, the industry's continued profitability will be affected by uncertainties, including the future condition of the economy, that will in turn impact

[2] FICO, established in 1987 to recapitalize FSLIC, has first claim on assessments of SAIF members for payment of interest and custodial costs on its bonds. Although FICO no longer has authority to issue bonds, its claim to the assessments will continue until the 30-year recapitalization bonds mature. In addition, REFCORP, established in 1989 to provide funding for RTC, was entitled to assessments of SAIF members to finance payment of bond principal. REFCORP ceased all future bond issuances in early 1991 and therefore has no further claim to assessments. Finally, FRF, established in 1989 to liquidate the assets and liabilities of the former FSLIC, is entitled, through December 31, 1992, to assessments from SAIF members not taken by FICO or REFCORP.

[3] All of SAIF's Oakar assessments had been requested by and given to FRF. SAIF's $108 million receivable as of December 31, 1991, consists of $105 million of Oakar assessments paid to FRF during 1990 and 1991 plus $3 million of interest income for FRF's use of the Oakar assessments. No Oakar banks existed in 1989.

SAIF's exposure to potential insurance losses. If the interest rate spread continues to be favorable, many poorly capitalized thrifts may remain marginally viable, and their failure may be delayed until after September 1993 when SAIF takes on its full resolution responsibility. In addition, some thrifts have bolstered their earnings by selling a portion of their income-producing, quality assets. However, by selling some of their better assets, these thrifts are left with a greater proportion of non-income producing, poor-quality assets that could reduce future earnings, thus making those thrifts more vulnerable to failure.

RTC's continued resolution progress will have a significant effect on SAIF's exposure to insurance losses. Under FIRREA, RTC was to resolve thrifts previously insured by FSLIC for which a conservator or receiver was appointed by August 9, 1992, leaving a smaller but healthier industry to be insured by SAIF. However, the cleanup of the thrift industry is taking longer than originally planned. The Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 extended RTC's resolution authority through September 30, 1993, to enable SAIF to assume its responsibilities without a backlog of institutions requiring resolution.

Between August 9, 1989, and December 31, 1991, RTC resolved a total of 584 thrifts. As of December 31, 1991, OTS had identified another 190 thrifts as probable resolution candidates and anticipates that RTC will resolve these thrifts by September 30, 1993 – the last date RTC can accept thrifts for resolution. Of the 190 thrifts, 91 were in conservatorship as of December 31, 1991, and thus will remain RTC's responsibility. The remaining 99 thrifts were either unprofitable or had poor earnings. OTS also had identified another 70 thrifts, including several large California thrifts, as possible candidates for resolution by September 30, 1993. However, as of May 11, 1992, RTC had not been provided with the requested funds necessary to continue thrift resolutions. If RTC is not given sufficient funding to resolve the thrifts requiring resolution for which a conservator or receiver is not appointed by the 1993 deadline, these thrifts will become SAIF's resolution responsibility. In addition to the 190 probable and 70 possible thrift resolution candidates, OTS considers another 260 thrifts as troubled. However, according to OTS, these thrifts are not likely to fail within the next 2 years. Therefore, if general economic conditions worsen, or interest rates rise and these marginal thrifts actually fail, SAIF will have resolution responsibility.

To monitor the condition of the thrift industry, OTS classifies private sector thrifts into four groups based on their ability to meet capital standards, their prospects for future viability, and the results of supervisory/regulatory examinations. OTS defines these groups as follows:

- Group I thrifts are well-capitalized and profitable.
- Group II thrifts currently meet or are expected to meet capital requirements.
- Group III thrifts are "troubled," with poor earnings and low capital. OTS does not expect that all thrifts in this group will require assistance. However, included in this group are the several large California thrifts that OTS believes may need assistance within the next year.
- Group IV thrifts have negative tangible capital and are consistently unprofitable. OTS expects that all thrifts in this group will require resolution; however, eight of these thrifts' resolutions are expected to be at no cost to the government.

At December 31, 1991, OTS classified the remaining 2,096 private sector thrifts into the above groups as shown in table 1.

Table 1: OTS Classifications

Dollars in billions

	OTS groups				
	I	II	III	IV	Total
Thrifts	983	676	372	65	**2,096**
Percent of industry	47	32	18	3	**100**
Assets held by thrifts	$312	$299	$229	$49	**$889**
Percent of industry's assets	35	34	26	5	**100**

At the end of 1991, OTS reported that Group IV thrifts comprised 3 percent of the industry compared with 8 percent at the end of 1990, and that thrifts in Group IV held 5 percent of the industry's assets compared with 13 percent at the end of 1990. In addition, in 1991 there was a small increase in the percentage of Group I thrifts, which are thrifts that OTS considers to be well-capitalized and profitable.

SAIF's Increased Exposure to Losses From Bank Failures

The financial condition of the banking industry is of increasing importance to SAIF because the number of Oakar banks has more than doubled over the past year, increasing SAIF's exposure to losses incurred from bank failures. Since Oakar banks are created primarily through the resolution of thrifts, the number of Oakar banks is expected to increase as thrift resolutions continue. At the end of 1991, 305 Oakar banks held approximately

$61 billion of SAIF-insured deposits, or 8 percent of SAIF's total insured deposits, compared with 138 Oakar banks holding $31 billion of SAIF-insured deposits, or 3.7 percent of SAIF's total insured deposits, at the end of 1990. During 1991, in addition to the one Oakar bank that was closed, FDIC identified nine Oakar banks with assets of $26 billion and estimated SAIF-insured deposits of $3 billion as exhibiting serious financial weaknesses and/or potential unsafe and unsound conditions that could impair their viability and therefore expose SAIF to insurance losses.

Adequacy of SAIF's Funding Sources Is Uncertain

As amended, the FDI Act provides SAIF with two primary revenue sources – insurance assessments and Treasury payments – that may be used for resolution activity. Through December 1992, SAIF will receive insurance assessments only on SAIF-insured deposits held by Oakar banks. After December 1992, SAIF will receive all insurance assessments—from thrifts and Oakar banks—except for the portion used to pay interest on FICO bonds. The FDI Act provides for Treasury payments as a back-up funding source to insurance assessments. To the extent that these assessments do not total $2 billion a year, section 11(a)(6) requires the Treasury to fund the difference for each fiscal year from 1993 through 2000. Assuming funds are appropriated, SAIF is assured of at least $16 billion in either assessment income or Treasury payments during this 8-year period. Section 11(a)(6) also requires the Treasury to make annual payments necessary to ensure that SAIF has a specified net worth, ranging from zero during fiscal year 1992 to $8.8 billion during fiscal year 2000. The cumulative amounts of these net worth payments cannot exceed $16 billion. Finally, section 11(a)(6) provides an authorization for funds to be appropriated to the Secretary of the Treasury for purposes of these payments.

Assuming optimistic deposit growth rates of 5 percent a year and no change in assessment rates applied against these deposits, SAIF's assessment income is not likely to exceed $2 billion in any year through 2000. Thus, the maximum amount from insurance assessments and Treasury payments that SAIF will receive under the statutory scheme through 2000 is not likely to exceed $32 billion. Whether these revenue sources will be sufficient to enable SAIF to carry out its responsibilities and still achieve its specified net worth goals will depend on resolution demands.

In addition to minimum net worth levels, the FDI Act, as amended by FIRREA, established a designated reserve ratio for SAIF of 1.25 percent of its insured deposits. SAIF is currently well below this designated reserve ratio. As of December 31, 1991, SAIF's reserve ratio was essentially zero, and is not expected to improve through 1992 due to the payment of SAIF insurance assessments to FICO and FRF. As of December 31, 1991, SAIF would have needed a fund balance or reserve of approximately $10.5 billion to have met the 1.25 percent designated reserve ratio. To meet this ratio at the end of 1992, SAIF will need a lower reserve of approximately $9.5 billion, assuming no SAIF insurance losses and continued shrinkage of the industry due to RTC resolutions during 1992.

The FDI Act states that the SAIF assessment rate shall be set by FDIC to maintain SAIF's reserve at its designated reserve ratio or to increase the reserve ratio to the designated ratio within a reasonable period of time. The FDI Act, as amended by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDIC Improvement Act), also requires FDIC to implement a risk-based premium system by January 1, 1994. Under this system, insured institutions considered to pose a greater risk of loss to SAIF would be assessed at higher rates than stronger, well-capitalized and better-managed institutions. FDIC may implement a transitional risk-based premium system prior to January 1, 1994.

In May 1992, FDIC proposed an assessment rate increase from the current rate of 23 cents per $100 of domestic deposits to 28 cents effective January 1, 1993. This proposed rate increase is based on FDIC's analysis of the condition of SAIF and its ability to achieve the designated reserve ratio over the next 15 years. This assessment rate increase, along with assessments imposed under FDIC's risk-based assessment system to be in effect by January 1, 1994, are designed to allow SAIF to reach the designated reserve ratio within a reasonable period of time.[4] FDIC's analysis supporting this rate determination did not consider the Treasury payments required by the FDI Act because FDIC is not certain that the Congress would appropriate the funds for these Treasury payments.[5]

In addition to the revenue sources mentioned above, FDIC may borrow from a number of sources on behalf of SAIF. Under the FDI Act, as amended by the FDIC Improvement Act, FDIC's borrowings are subject to a formula that limits its total outstanding obligations. FDIC may borrow up to $30 billion

[4]If FDIC adopts a risk-based premium structure to become effective at the same time as the proposed rate increase, the increased assessment rate would be the target average assessment rate of SAIF members, which is also 28 cents per $100 of domestic deposits.

[5]The Federal Register; p. 21,627; May 21, 1992.

from the Treasury to cover losses incurred in resolving institutions insured by SAIF or BIF. Such borrowing is to be a liability of the related fund and is to be repaid by the respective fund through insurance assessments. Because the $30 billion is available for both SAIF and BIF, the amount of borrowing authority available for SAIF will largely depend on BIF's borrowing demands. In addition, subject to the limitation on FDIC's outstanding obligations, FDIC may borrow funds for working capital from the Federal Financing Bank and, with the concurrence of the Federal Housing Finance Board, may borrow from the Federal Home Loan Banks on behalf of SAIF.

Although it appears that the Congress has provided SAIF with funding sources that will allow SAIF to meet its obligations, given the uncertainties over the actual funds that will be available, SAIF's future viability cannot be reliably predicted.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

May 11, 1992

Report on Internal Control Structure

We have audited the financial statements of the Savings Association Insurance Fund (SAIF) as of December 31, 1991 and 1990, and have issued our opinion thereon. This report pertains only to our consideration of the Federal Deposit Insurance Corporation's (FDIC) internal control structure as it relates to SAIF for the year ended December 31, 1991. The report on our consideration of FDIC's internal control structure as it relates to SAIF for the year ended December 31, 1990, is presented in GAO/AFMD-92-21, dated January 8, 1992.

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, we considered SAIF's internal control structure in order to determine what auditing procedures were needed for purposes of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

FDIC's management is responsible for establishing and maintaining an internal control structure over SAIF. 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 FDIC's significant internal control structure policies and procedures, including those related to compliance with applicable laws and regulations, for SAIF into the following categories:

- troubled institutions, consisting of policies and procedures for recognizing SAIF's losses and/or liabilities for resolution transactions;
- revenue, consisting of policies and procedures for SAIF's insurance assessment and entrance and exit fee transactions;
- treasury, consisting of policies and procedures for SAIF's cash and investment transactions;
- payroll, consisting of policies and procedures for SAIF's payroll transactions;
- other expenses, consisting of policies and procedures related to SAIF's travel and procurement transactions; and
- financial reporting, consisting of policies and procedures related to the form, content, and preparation of SAIF's financial statements.

For each internal control structure category listed above, we obtained an understanding of the design of the relevant policies and procedures and assessed the risk that internal controls are not operating as intended. We performed tests of control procedures over all categories above except for troubled institutions and treasury transactions for which we found it more efficient to rely solely on substantive audit tests. 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.

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,[6] 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 identified two matters involving FDIC's internal control structure and operations for SAIF which we consider to be material weaknesses under generally accepted government auditing standards. Specifically, we identified material

[6]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.

weaknesses (1) in FDIC's process for estimating SAIF's potential insurance losses and (2) in FDIC's time and attendance practices. However, through the performance of substantive testing and alternate auditing procedures, we were able to obtain reasonable assurance that the material financial statement balances affected by the above weaknesses were fairly stated as of December 31, 1991, and for the year then ended.

Weaknesses in FDIC's Process for Estimating SAIF's Potential Insurance Losses

FDIC does not have an adequate process for estimating SAIF's potential insurance losses. As a result, FDIC may not accurately estimate SAIF's potential losses to be incurred from the failure of Oakar banks.[7]

FDIC has a methodology for evaluating institutions that are potential resolution candidates and estimating their potential resolution cost; however, this methodology was developed for institutions insured by the Bank Insurance Fund. Specifically, FDIC performs an in-depth review of potential resolution candidates with assets over $100 million in order to determine their potential resolution cost. To determine the potential cost of resolution candidates with assets under $100 million, which FDIC refers to as "small banks," FDIC applies an historical loss percentage based on experience with small bank resolutions. While this methodology is reasonable for estimating potential insurance losses material to the Bank Insurance Fund, it is not precise enough to identify potential losses that may be material to SAIF, which is currently a much smaller entity. As of December 31, 1991, there were 73 Oakar banks with assets under $100 million. The failure of any one of these banks could materially affect SAIF's financial position. In contrast, the failure of a small Oakar bank would not materially affect the Bank Insurance Fund's financial position.

Internal Controls Over Payroll Transactions Need To Be Enforced

Although FDIC has policies and procedures governing its time and attendance reporting process, FDIC is not consistently following these policies and procedures. Since FDIC's time and attendance reporting is the principal means for allocating its payroll expenses for each of the three funds it administers, control procedures over FDIC's time and attendance

[7]Pursuant to section 5(d)(3) of the Federal Deposit Insurance Act, banks can acquire deposits of thrift institutions without changing insurance coverage for these acquired deposits. Accordingly, acquired thrift deposits continue to be insured by SAIF. Resolution costs associated with the failure of a bank holding both Bank Insurance Fund (BIF)-insured and SAIF-insured deposits are allocated between BIF and SAIF based on the amounts of the respective insured deposits. Banks holding both BIF- and SAIF-insured deposits are referred to as "Oakar banks."

reporting are particularly important in assuring that SAIF is recognizing the proper amount of payroll expense.

FDIC is responsible for administering and separately accounting for SAIF, the Bank Insurance Fund, and the FSLIC Resolution Fund. FDIC allocates certain overhead expenses, including payroll expenses, among these three funds based on the percentage of time employees report having worked on a particular fund. FDIC employees are responsible for determining and documenting on their time cards the hours worked on each fund. Therefore, time cards are the primary source for determining which fund should be charged for the related payroll expense.

SAIF's payroll expenses accounted for 46 percent of its total expenses during 1991. As part of our testing of SAIF's payroll expenses, we randomly selected 60 time cards from the total submitted by FDIC employees during the first 9 months of 1991 and examined them for proper signatures and agreement with various payroll reports. We also reviewed the time cards and related payroll reports for conformance with FDIC's Time and Attendance Reporting Directive.

Our review disclosed significant weaknesses over FDIC's time and attendance reporting process. For example, we found

- 12 (20 percent) instances in which time cards and 30 (50 percent) instances in which payroll reports were missing required supervisor and/or timekeeper signatures;
- 9 (15 percent) instances in which timekeepers made changes to time card data without required approval from the employee or the employee's supervisor;
- 17 (28 percent) instances in which payroll reports were not reconciled to the time card as required in order to verify that the data on the time card was properly input into the payroll system; and
- 29 (48 percent) instances in which employees were not provided a copy of their processed time card data as required, which would allow them to review the accuracy of their attendance data that was input into the payroll system.

Conclusion

Through the performance of substantive testing and alternate auditing procedures, we were able to obtain reasonable assurance that the material financial statement balances affected by the loss estimation and payroll weaknesses were fairly stated as of December 31, 1991, and for the year then ended. However, the existence of these conditions greatly increases the risk that related balances may become materially misstated in the future if these problems are not corrected.

Recommendations

We recommend that the Chairman, FDIC, direct the Director, Division of Accounting and Corporate Services, to

- develop and implement procedures for performing an in-depth analysis of small Oakar banks, similar to the analysis of large Oakar banks, to ensure that FDIC accurately estimates potential insurance losses for SAIF.

We also recommend that the Chairman direct FDIC's division and office heads to

- enforce the policies and procedures documented in FDIC's Time and Attendance Reporting Directive to ensure that employees' time charges are valid and that payroll expenses are charged to the correct fund.

Other Opportunities for Improvement

During the course of our audit, we identified a number of other weaknesses regarding SAIF's internal control structure. Although we did not consider these weaknesses to be material to SAIF's 1991 financial statements, they nonetheless merit corrective action to strengthen FDIC's internal controls over SAIF transactions. Consequently, we have communicated these weaknesses separately to the appropriate FDIC officials.

Agency Views

While we did not request written comments on this report, we did communicate these weaknesses to responsible FDIC officials. With regard to FDIC's weaknesses over its process for estimating SAIF's insurance losses, FDIC officials acknowledged the shortfalls in the current methodology for estimating SAIF's insurance losses and told us FDIC would develop procedures for analyzing small Oakar banks identified as potential resolution candidates in its 1992 review of SAIF's estimated losses. Also, FDIC acknowledges the need for strong internal controls over its time and attendance reporting and is planning corrective action. We will follow up on actions that FDIC takes concerning these internal control weaknesses during our planned 1992 financial statement audit.

Report on Compliance With Laws and Regulations

We have audited the financial statements of the Savings Association Insurance Fund (SAIF) for the years ended December 31, 1991, and December 31, 1990, and have issued our opinion thereon. This report pertains only to our review of the Federal Deposit Insurance Corporation's (FDIC) compliance with laws and regulations as they relate to SAIF for the year ended December 31, 1991. The report on our review of FDIC's compliance with laws and regulations as they relate to SAIF for the year ended December 31, 1990, is presented in GAO/AFMD-92-21, dated January 8, 1992.

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.

FDIC's management is responsible for compliance with laws and regulations applicable to SAIF. As part of obtaining reasonable assurance as to whether the financial statements were free of material misstatement, we selected and tested transactions and records to determine FDIC's compliance with relevant provisions of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1811 et seq.), which, if not complied with, could have a material effect on SAIF's financial statements. These provisions are contained in sections 1815, 1817, and 1821 through 1825 of title 12, United States Code. However, it should be noted that our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion. Also, 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 FDIC has to comply.

The results of our tests indicate that with respect to the items tested, FDIC complied, in all material respects, with those provisions of laws and regulations referred to above. With respect to transactions not tested, nothing came to our attention that caused us to believe that FDIC had not complied, in all material respects, with those provisions.

Financial Statements

Statements of Financial Position

(dollars in thousands)

	December 31	
	1991	1990
Assets		
Cash and cash equivalents, including restricted amounts of $56,119 for 1991 and $12,964 for 1990 (Note 3)	$ 56,681	$ 16,535
Entrance and exit fees receivable, net (Note 4)	91,015	49,384
Due from the FSLIC Resolution Fund (Note 11)	109,561	17,010
Other assets	745	626
	258,002	83,555
Liabilities and the Fund Balance		
Accounts payable, accrued and other liabilities	3,428	4,100
Due to the Bank Insurance Fund (Note 5)	20,723	-0-
Total Liabilities	24,151	4,100
SAIF-member exit fees and investment proceeds held in reserve (Note 4)	146,693	62,454
Fund Balance	87,158	17,001
	$ 258,002	$ 83,555

The accompanying notes are an integral part of these financial statements.

Statements of Income and the Fund Balance

(dollars in thousands)

	For the Year Ended December 31	
	1991	1990
Revenue		
Assessments earned (Note 11)	$ 87,964	$ 16,999
Entrance fee revenue (Note 4)	8	-0-
Interest income	2,908	-0-
	90,880	16,999
Expenses and Losses		
Administrative expenses	42,362	56,088
Provision for losses (Note 5)	20,114	-0-
Interest expense (Note 5)	609	-0-
	63,085	56,088
Net Income (Loss) before Funding Transfer	27,795	(39,089)
Funding Transfer from the FSLIC Resolution Fund (Note 1)	42,362	56,088
Net Income	70,157	16,999
Fund Balance - Beginning	17,001	2
Fund Balance - Ending	$ 87,158	$ 17,001

The accompanying notes are an integral part of these financial statements.

Statements of Cash Flows

(dollars in thousands)

	For the Year Ended December 31	
	1991	1990
Cash Flows From Operating Activities		
Cash inflows from:		
Administrative expenses funded by the FSLIC Resolution Fund (Note 1)	$ 40,650	$ 56,088
Entrance and exit fee collections (Note 4)	40,868	12,961
Interest on U.S. Treasury obligations	2,207	5
Cash outflows for:		
Transition assessment payment transferred to the FSLIC Resolution Fund (Note 6)	-0-	120
Administrative expenses (Note 1)	43,579	52,399
Net Cash Provided By Operating Activities (Note 10)	**40,146**	**16,535**
Cash and Cash Equivalents - Beginning	**16,535**	**-0-**
Cash and Cash Equivalents - Ending	**$ 56,681**	**$ 16,535**

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements

DECEMBER 31, 1991 and 1990

1. Legislative History and Reform

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was enacted to reform, recapitalize and consolidate the federal deposit insurance system. FIRREA designated the Federal Deposit Insurance Corporation (FDIC) as administrator of the Bank Insurance Fund (BIF), which insures the deposits of all BIF-member institutions (normally commercial banks), and the Savings Association Insurance Fund (SAIF), which insures the deposits of all SAIF-member institutions (normally thrifts). Both insurance funds are maintained separately to carry out their respective mandates. The FDIC also administers the FSLIC Resolution Fund (FRF) which is responsible for winding up the affairs of the former Federal Savings and Loan Insurance Corporation (FSLIC).

FIRREA created the Resolution Trust Corporation (RTC), which manages and resolves all thrifts previously insured by the FSLIC for which a conservator or receiver is appointed during the period January 1, 1989 through August 8, 1992. The Resolution Trust Corporation Refinancing, Restructuring and Improvement Act of 1991 (1991 RTC Act) extended the RTC's general resolution authority through September 30, 1993, and beyond that date for those institutions previously placed under RTC control.

The Resolution Funding Corporation (REFCORP) was established by FIRREA to provide funds to the RTC for use in the thrift industry bailout. The Financing Corporation (FICO), established under the Competitive Equality Banking Act of 1987, is a mixed-ownership government corporation whose sole purpose was to function as a financing vehicle for the FSLIC. However, effective December 12, 1991, as provided by the Resolution Trust Corporation Thrift Depositor Protection Reform Act of 1991, the FICO's authority to issue obligations as a means of financing for the FRF was terminated.

The Omnibus Budget Reconciliation Act of 1990 removed caps on assessment rate increases and allowed for semiannual rate increases. In addition, this Act permitted the FDIC, on behalf of the BIF and SAIF, to borrow from the Federal Financing Bank (FFB) on terms and conditions determined by the FFB.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (1991 Act) was enacted to further strengthen the FDIC. The FDIC's authority to borrow from the U.S. Treasury was increased from $5 billion to $30 billion. However, the FDIC cannot incur any additional obligation for the BIF or the SAIF if the amount of obligations in the respective Fund would exceed the sum of: 1) its cash and cash equivalents; 2) the amount equal to 90 percent of the fair-market value of its other assets; and 3) its portion of the total amount authorized to be borrowed from the U.S. Treasury (excluding FFB borrowings).

As required by the 1991 Act, U.S. Treasury borrowings are to be repaid from assessment revenues. The FDIC must provide the U.S. Treasury a repayment schedule demonstrating that future assessment revenues are adequate to repay principal borrowed and pay interest due. In addition, the FDIC now has authority to increase assessment rates more frequently than semiannually and impose emergency special assessments as necessary to ensure that funds are available for these payments.

Operations of the SAIF. The primary purpose of the SAIF is to insure the deposits and to protect the depositors of insured savings associations. In this capacity, the SAIF currently has financial responsibility for: 1) all federally insured depository institutions that became members of the SAIF after August 8, 1989, for which RTC does not have resolution authority; and 2) all deposits insured by the SAIF which are held by BIF-member banks (so called "Oakar" banks, created pursuant to the "Oakar amendment" provisions found in Section 5(d)(3) of the FDI Act). After September 30, 1993, SAIF will assume financial responsibility for all SAIF-member depository institutions which had not previously been placed under the RTC's control.

The "Oakar amendment" provisions referred to above allow, with approval of the appropriate federal regulatory authority, any insured depository institution to merge, consolidate, or transfer the assets and liabilities of an acquired institution(s) without changing insurance coverage for the acquired deposits. Such acquired deposits continue to be either SAIF-insured deposits and assessed at the SAIF assessment rate or BIF-insured deposits and assessed at the BIF assessment rate. In addition, any losses resulting from the failure of these institutions are to be allocated between the BIF and SAIF based on the respective dollar amounts of the institution's BIF-insured and SAIF-insured deposits.

The SAIF is funded from the following sources: 1) Reimbursement by the FRF of administrative and supervisory expenses incurred between August 9, 1989 and September 30, 1992. These expenses have priority over other obligations of the FRF and funding is provided as expenses are recognized by the SAIF; 2) SAIF member assessments from "Oakar" banks; 3) SAIF assessments that are not required for the FICO, the REFCORP, or the FRF; 4) U.S. Treasury payments for the amount, if any, needed to supplement assessment revenue to reach a $2 billion level for each of the fiscal years 1993 through 2000; 5) U.S. Treasury payments for any additional amounts that may be necessary to ensure that the SAIF has a statutory specified minimum net worth for each of the fiscal years 1992 through 2000; 6) discretionary payments by the RTC; 7) Federal Home Loan Bank borrowings; and 8) U.S. Treasury and FFB borrowings.

2. Summary of Significant Accounting Policies

Assessment Revenue Recognition. FIRREA directed that the FICO, the REFCORP and the FRF have priority over the SAIF for receiving and utilizing SAIF-member assessments to ensure availability of funds for specific operational activities. Accordingly, the SAIF recognizes as assessment revenue only that portion of SAIF-member assessments not required by the FICO, the REFCORP or the FRF. Assessments on SAIF-insured deposits by "Oakar" banks are retained in the SAIF and, thus, are not subject to draws by the FICO, the REFCORP or the FRF (see Note 11).

Litigation Losses. The SAIF includes in current period expenses the change in the estimated loss from litigation against the SAIF. The FDIC Legal Division recommends these estimated losses on a case-by-case basis. As of December 31, 1991 and 1990, no litigation was pending against the SAIF.

Cost Allocations Among Funds. Operating expenses (including personnel, administrative and other indirect expenses) not directly charged to each Fund under the FDIC's management are allocated on the basis of the relative degree to which the expenses were incurred by the Funds.

The cost of furniture, fixtures and equipment purchased by the FDIC on behalf of the three Funds under its administration is allocated among these Funds on a pro rata basis. The SAIF expenses its share of these allocated costs at the time of acquisition because capitalizing these expenditures would not be cost-beneficial to the SAIF.

Related Parties. The nature of related parties and descriptions of related party transactions are disclosed throughout the financial statements and footnotes.

Restatement. A restatement was made to the 1990 financial statements regarding assessments paid on SAIF deposits by "Oakar" banks (see Note 11).

Reclassifications. Reclassifications have been made in the 1990 Financial Statements to conform to the presentation used in 1991.

3. Cash and Cash Equivalents

The SAIF considers cash equivalents to be short-term, highly liquid investments with original maturities of three months or less. Cash and cash equivalents as of December 31 consisted of the following (in thousands of dollars):

	1991	1990
Cash	$ 491	$ 6,241
Cash equivalents	56,190	10,294
	$ 56,681	**$ 16,535**

SAIF exit fees collected plus interest (See Note 4) comprise substantially all of the cash and cash equivalent balances and may only be used to meet SAIF's potential obligation to the FICO.

4. Entrance and Exit Fees

The SAIF will receive entrance and exit fees for conversion transactions in which an insured depository institution converts from the BIF to the SAIF (resulting in an entrance fee) or from the SAIF to the BIF (resulting in an exit fee). Interim regulations approved by the FDIC Board of Directors and published in the Federal Register on March 21, 1990, directed that exit fees paid to SAIF be held in a reserve account until the FDIC and the Secretary of the Treasury determine that it is no longer necessary to reserve such funds for the payment of interest on obligations previously issued by the FICO. It is the FDIC's policy to invest exit fee collections in overnight Treasury securities and hold the proceeds in reserve pending determination of ownership.

The SAIF records entrance fees as revenue after the BIF-to-SAIF conversion transaction is consummated. However, due to the requirement that SAIF exit fees be held in a reserve account, thereby restricting the SAIF's use of such proceeds, the SAIF does not recognize exit fees, nor any interest earned, as revenue. Instead, the SAIF recognizes the consummation of a SAIF-to-BIF conversion transaction by establishing a receivable from the institution and an identical reserve account to recognize the potential payment to the FICO. As exit fee proceeds are received, the receivable is reduced while the reserve remains pending the determination of funding requirements for interest payments on the FICO's obligations.

Within specified parameters, the interim regulations allow an acquiring institution to pay its entrance/exit fees due, interest free, in equal annual installments over a period of not more than five years. When an institution elects such a payment plan, the SAIF records the entrance or exit fee receivable at its present value. The discount rates (current value of funds) for 1991 and 1990 was 8% and 9%, respectively.

Entrance and Exit Fees Receivable as of December 31 consisted of the following (in thousands of dollars):

	1991	1990
Entrance Fees Receivable	$ 10	$ 2
Entrance Fees Collected	(10)	(2)
Exit Fees Receivable	159,510	71,525
Exit Fees Collected	(53,358)	(12,991)
Unamortized Discount	(15,137)	(9,150)
	$ 91,015	**$ 49,384**

5. Due to the Bank Insurance Fund

On September 19, 1991, Southeast Bank, N.A., Miami, Florida which held deposits insured by BIF and SAIF pursuant to the "Oakar amendment" provisions (as explained in Note 1), was closed by its chartering authority. The BIF, which provided the funds and administers the resolution of Southeast Bank, N. A., has estimated the loss for the failure of Southeast Bank, N.A., and its affiliate Southeast Bank of West Florida, Pensacola, at $178 million, of which SAIF has responsibility for $21 million (its allocated share of the loss incurred). Accordingly, the SAIF has established a payable to the BIF for its estimated transaction cost. In addition, interest will accrue on the SAIF's obligation based on the quarterly FFB borrowing rate. During 1991 this rate ranged between 4.7% and 5.9%.

6. Assessments

Assessment Rate. The rate set for 1991 is 0.23 percent (23 cents per $100 of domestic deposits). Based on the present and projected status of the SAIF, and anticipated expenses and revenue for the next year, the ratio of the deposit insurance fund to insured deposits is not expected to exceed the current designated reserve ratio of 1.25 percent.

Transition Assessment. In September 1989, the FDIC allowed for a one-time transition assessment against SAIF members. A portion of this special assessment was claimed by the FICO for debt servicing needs and the remaining amount was allocated to the FRF. The $120,000 in interest remaining to be transferred to the FRF as of December 31, 1989, was paid in 1990.

Secondary Reserve Offset. The FDI Act authorizes insured savings associations to offset against any assessment premiums their pro rata share of amounts that were previously part of the FSLIC's "Secondary Reserve". The secondary reserve represented premium prepayments that insured savings institutions were required by law to deposit with the FSLIC during the period 1961 through 1973 to quickly increase FSLIC's insurance reserves to absorb losses if the regular assessments were insufficient. The allowable offset is limited to a maximum of 20 percent of an institution's remaining pro rata share for any calendar year beginning before 1993. After calendar year 1992, there is no limitation on the remaining offset amount.

The Secondary Reserve offset serves to reduce the gross SAIF-member assessments due (excluding assessments from "Oakar" banks), thereby reducing the assessment premiums available to the FICO, the REFCORP, the FRF and the SAIF. The remaining Secondary Reserve balance was $297,761,164 and $359,121,134 at year end 1991 and 1990, respectively.

1991 and 1990 assessments against SAIF members and "Oakar" banks were as follows (in thousands of dollars):

	1991	1990
SAIF assessments collected from SAIF members (net of Secondary Reserve offset and other adjustments/credits of $72,992 and $101,152 in 1991 and 1990)	$ 1,795,227	$ 1,811,443
SAIF assessments earned from "Oakar" banks	87,964	16,999
Total assessment earned from SAIF members and "Oakar" banks	1,883,191	1,828,442
Less: FICO assessment	(756,700)	(738,200)
REFCORP assessment	-0-	(1,061,495)
Funds recognized by the FRF	(1,038,527)	(11,748)
Funds owed to the SAIF	87,964	16,999

7. Pension Benefits, Savings Plans and Accrued Annual Leave

Eligible FDIC employees (i.e., all permanent and temporary employees with an appointment exceeding one year) are covered by either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). The CSRS is a defined benefit plan integrated with the social security system in certain cases. Plan benefits are determined on the basis of years of creditable service and compensation levels. The CSRS-covered employees can also participate in a federally sponsored tax-deferred savings plan available to provide additional retirement benefits. The FERS is a three part plan consisting of a basic defined benefit plan which provides benefits based on years of creditable service and compensation levels, social security benefits and a tax-deferred savings plan. Further, automatic and matching employer contributions are provided up to specified amounts under the FERS. Eligible employees may participate in an FDIC sponsored tax-deferred savings plan with matching contributions. The SAIF pays the employer's portion of the related costs.

The SAIF's allocated share of pension benefits and savings plans expenses as of December 31, 1991 and 1990 consisted of the following (in thousands of dollars):

	1991	1990
Civil Service Retirement System	$ 771	$ 840
Federal Employee Retirement System (Basic Benefits)	1,303	1,187
FDIC Savings Plan	754	735
Federal Thrift Savings Plan	318	256
	$ 3,146	$ 3,018

The liability to employees for accrued annual leave is approximately $1,305,000 and $1,610,000 at December 31, 1991 and 1990, respectively.

Although the SAIF contributes a portion of pension benefits for eligible employees, it does not account for the assets of either retirement system, nor does it have actuarial data with respect to accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported and accounted for by the U.S. Office of Personnel Management.

8. FDIC Health, Dental and Life Insurance Plans for Retirees

The FDIC provides certain health, dental and life insurance coverage for its eligible retirees. Eligible retirees are those who have elected the FDIC's health and/or life insurance program and are entitled to an immediate annuity. The health insurance coverage is a comprehensive fee-for-service program underwritten by Blue Cross/Blue Shield of the National Capital Area, with hospital coverage and a major medical wrap-around; the dental care is underwritten by Connecticut General Insurance Company. The FDIC makes the same contributions for retirees as those for active employees. The FDIC benefit programs are fully insured. Effective January 1, 1991, the funding mechanism was changed to a "minimum premium funding arrangement". Fixed costs and expenses for claims are paid as incurred. Premiums are deposited for claims incurred but not reported. The premiums are held by the FDIC.

The life insurance program is underwritten by Metropolitan Life Insurance Company. The program provides for basic coverage at no cost and allows converting optional coverages to direct-pay plans with Metropolitan Life. The FDIC does not make any contributions towards annuitants' basic life insurance coverage; this charge is built into rates for active employees.

The SAIF's allocated share of retiree benefits provided as of December 31 are as follows (in thousands of dollars):

	1991	1990
Health premiums paid	$ 27	$ 41
Dental premiums paid	1	4

The Financial Accounting Standards Board has issued Statement of Financial Accounting Standard No. 106, (Employers' Accounting for Postretirement Benefits Other Than Pensions), which the FDIC is required to adopt by 1993. The standard requires companies to recognize postretirement benefits during the years employees are working and earning benefits for retirement. Resulting estimated expenses will be allocated to the SAIF based on the relative degree to which expenses were incurred. Although the impact of the FDIC's adoption of the standard cannot reasonably be estimated at this time, the standard may increase reported administrative costs and expenses of the SAIF.

9. Commitments

The SAIF is currently sharing in the FDIC's lease of office space. The SAIF's lease commitments for office space total $1,976,000 for future years. The agreements contain escalation clauses resulting in adjustments, usually on an annual basis. The SAIF's recognized leased space expense of approximately $1,668,325 and $3,383,000 for the years ended December 31, 1991 and 1990, respectively.

The SAIF's allocated share of leased space fees for future years, which are committed per contractual agreement, are as follows (in thousands of dollars):

1992	1993	1994	1995	1996
$ 684	$ 552	$ 391	$ 208	$ 141

10. Supplementary Information Relating to the Statements of Cash Flows

Reconciliation of net income to net cash provided by operating activities for the year ended December 31, 1991 and 1990 (in thousands of dollars):

	1991	1990
Net Income	$ 70,157	$ 16,999
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in due from the FSLIC Resolution Fund	(92,551)	(17,010)
Increase in entrance and exit fees receivable	(41,630)	(46,231)
Decrease (increase) in other assets	(119)	1,527
Increase (decrease) in accounts payable, accrued and other liabilities	(673)	1,947
Increase in due to the Bank Insurance Fund	20,723	-0-
Increase in exit fees and investment proceeds held in reserve	84,239	59,303
Net cash provided by operating activities	**$ 40,146**	**$ 16,535**

11. Subsequent Event

On March 27, 1992, the FDIC's Legal Division rendered the opinion that, under FIRREA, assessments paid on SAIF-insured deposits by "Oakar" banks must be retained in the SAIF, and, thus, are not subject to draws by the FICO, the REFCORP or the FRF. As FIRREA became effective in August 1989, the financial statements for 1990 have been restated. FRF received the assessments paid on SAIF-insured deposits in 1990 and 1991, therefore the effect of this restatement was to establish a receivable from FRF and to recognize assessment revenue of $17 million in 1990. Additionally, in 1991, the receivable from FRF was increased by $91 million, assessment revenue of $88 million and interest revenue of $3 million were recognized. In April 1992 SAIF received $108 million from the FRF, for the 1991 principal and interest receivables.

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