United States General Accounting Office

GAO

Report to the Honorable Bruce F. Vento, House of Representatives

April 1993

RESOLUTION TRUST CORPORATION

Controls Over Asset Valuations Do Not Ensure Reasonable Estimates

149078

GAO

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

General Government Division

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April 8, 1993

The Honorable Bruce F. Vento
House of Representatives

Dear Mr. Vento:

On October 31, 1991, you asked for information on the asset valuation review (AVR) process used by the Resolution Trust Corporation (RTC) in resolving thrifts. Specifically, you wanted to know whether this process produced reasonable loss estimates for a thrift's assets. To do this, we judgmentally selected and reviewed the AVR reports and supporting documents for six thrifts. We also reviewed work done by RTC's Inspector General (IG) relating to the preparation of AVR reports by contractors. This report discusses the development of the AVR reports and the supporting documents we reviewed. It also discusses RTC's Asset Review Evaluation System (ARES).

Results in Brief

Controls over the contract AVRS we reviewed were not sufficient to ensure that asset valuations were reasonable. On the basis of our review of a 25-percent sample of the asset review sheets supporting the six AVRS we reviewed, we were unable to conclude whether asset loss estimates were reasonable. This was because of (1) limited documentation or explanation supporting the methods, assumptions, and conclusions used in doing these AVRS; (2) minimal evidence of contractor supervisory review of the individual asset review sheets we examined; and (3) lack of evidence indicating the level and extent of review that RTC officials exercised in assessing the adequacy of the asset review sheets supporting asset valuation estimates. We believe these three internal control weaknesses put RTC at risk of using inaccurate or questionable data in cost tests.[1] Further, the results of our work corroborate the findings of RTC's IG, who was also unable to determine whether assets were properly valued because of the lack of sufficient supporting documentation as well as inadequate evidence of oversight of the asset valuations.

Furthermore, in addition to correcting the weaknesses in the existing process, RTC could further improve the AVR process by making greater use of available pertinent data in developing the asset loss figure for the cost test. RTC does not take advantage of the vast amount of actual data it has accumulated on asset recoveries. Use of these data, if done properly,

[1]The cost test calculates and compares the estimated costs of various resolution transactions with an insured deposit payout to identify the least costly resolution method.

would help RTC assure itself that asset valuation estimates were reasonable. Finally, RTC considers ARES fully functional although it has not been adequately tested under operational conditions. Some questions still exist about its ability to fulfill the system's design objectives. No AVR contractor personnel, who are the primary users of ARES, took part in the user acceptance test. Further, since the system was tested using only four assets, there is no assurance that the previously identified problems in handling large numbers of assets and merging data were corrected. RTC will need to closely monitor ARES' performance to ensure that all the known deficiencies in the system have been corrected and that it is working properly.

Background

The AVR process begins when a failed thrift's managing agent completes an AVR contract questionnaire and ends when a final AVR report is accepted by RTC. The goal of this process is to estimate the market value or the estimated recovery value (ERV) of a failed thrift's assets and the loss, if any, associated with the sale of those assets. The estimated loss is a key figure in the resolution cost test that RTC's Division of Institution Operations and Sales uses to compare the estimated cost of various resolution transactions to a direct payout to insured depositors.[2]

AVR Contracting Activity

RTC prequalifies contractors under a basic ordering agreement for AVR work.[3] In November 1991, RTC issued its last solicitation for services requesting qualified firms to submit competitive proposals for asset valuation services. In May 1992, it selected 45 firms to do AVRs under task orders[4] for 1 year or until a new solicitation is issued.

Through July 1992, RTC had resolved 652 thrifts. The AVRs for 396, 61 percent, of these thrifts were done by contractors. Twenty-one, 5 percent, of these AVRs were updated before the thrifts were resolved at a

[2]The cost test is discussed more fully in our July 16, 1992, correspondence, Asset Valuation Reviews and Cost Test (GAO/GGD-92-17R).

[3]A basic ordering agreement is a written understanding between RTC and a contractor intended for repetitive requirements under which contracting for future needs is expedited. It contains terms and conditions pertaining to future task orders, descriptions of services to be provided, and methods of pricing and evaluating task order proposals.

[4]A task order is the specific contract issued under the general terms of a basic ordering agreement, together with the specific terms of the contractor's task order proposal.

cost of $664,000.[5] The total cost of the contracted AVR work was $10.3 million. There were 66 thrifts remaining in RTC's inventory for which AVRs would be needed. Further, it is not known how many more thrifts will be placed under RTC control to be resolved and, therefore, how many more AVRs will be done by contractors.

In August 1992, RTC was doing only eight AVRs because a lack of adequate funds had slowed resolution activities. Seven of these AVRs were being done by in-house personnel and only one by contractor personnel. Since then, RTC has continued to use Resolutions staff to do AVRs. An RTC Resolutions official told us that when funding is approved and resolution activity increases, RTC will resume contracting for AVR services.

AVR Methodology

RTC's AVR methodology is described in its Methodology Description for Asset Valuation Reviews. The latest version, issued in August 1991, includes rules and procedures for sampling assets and selecting discount rates and holding periods to be used in calculating the ERV of a thrift's assets. It also requires a narrative section in the final AVR report summarizing the methods, assumptions, and conclusions. For example, the discount rates used in the report to estimate asset recovery values are to be justified and documented.

Inspector General Assessment of AVR Process

In April 1992, RTC's IG released the results of its nationwide compliance audit of RTC's asset valuation methods.[6] The IG found a lack of sufficient documentation to support the AVR conclusions and ERV calculations as well as inadequate evidence of oversight of the asset valuation process. Therefore, the IG was unable to tell whether RTC had properly valued its assets according to policies and procedures. Without proper support for the underlying assumptions of asset valuations, the IG concluded that the reliability of the valuations is questionable.

The IG recognized that RTC's asset valuation processes have evolved since RTC was created in August 1989. It also recognized that RTC tried to respond to the needs of prospective buyers, its own staff, and contractors by creating and improving its asset valuation tools. However, even though RTC had made efforts to improve asset valuations, the IG concluded that

[5] When RTC lacks sufficient funds to complete scheduled resolutions, it suspends its resolution activities until funds are available. Because the cost test requires current financial information, it is sometimes necessary to update an AVR when resolution activities are resumed.

[6] Asset Valuation Methods and the Appraisal Review Process, RTC Office of Inspector General (Audit Report A92-016, Apr. 28, 1992).

without clear support for an AVR report's conclusions, RTC cannot ensure that valuations are reasonable. Since RTC relies on contractors to do many of the asset valuations, the IG concluded that RTC has a responsibility to the American taxpayer to ensure that its contractors do quality work.

The IG recommended that RTC develop written guidelines that identify items that should be (1) included in the AVR contractor's workpapers and (2) used by project specialists in overseeing AVRS. The IG also recommended that the results of reviews and other oversight activities be clearly documented in the AVR files. RTC's response to the report noted that periodic training sessions had been held with AVR contractors and that in a meeting held in December 1991 for all AVR contractors it emphasized and discussed the need for adequate documentation to support their conclusions. RTC also stated it had added signature lines to the asset review sheet to ensure that the project specialist agrees with the contractor's assumptions and is involved in each phase of the AVR process. Finally, RTC suggested that ARES would correct many of the problems identified in the IG's report and agreed to implement the IG's recommendations.

Objectives, Scope, and Methodology

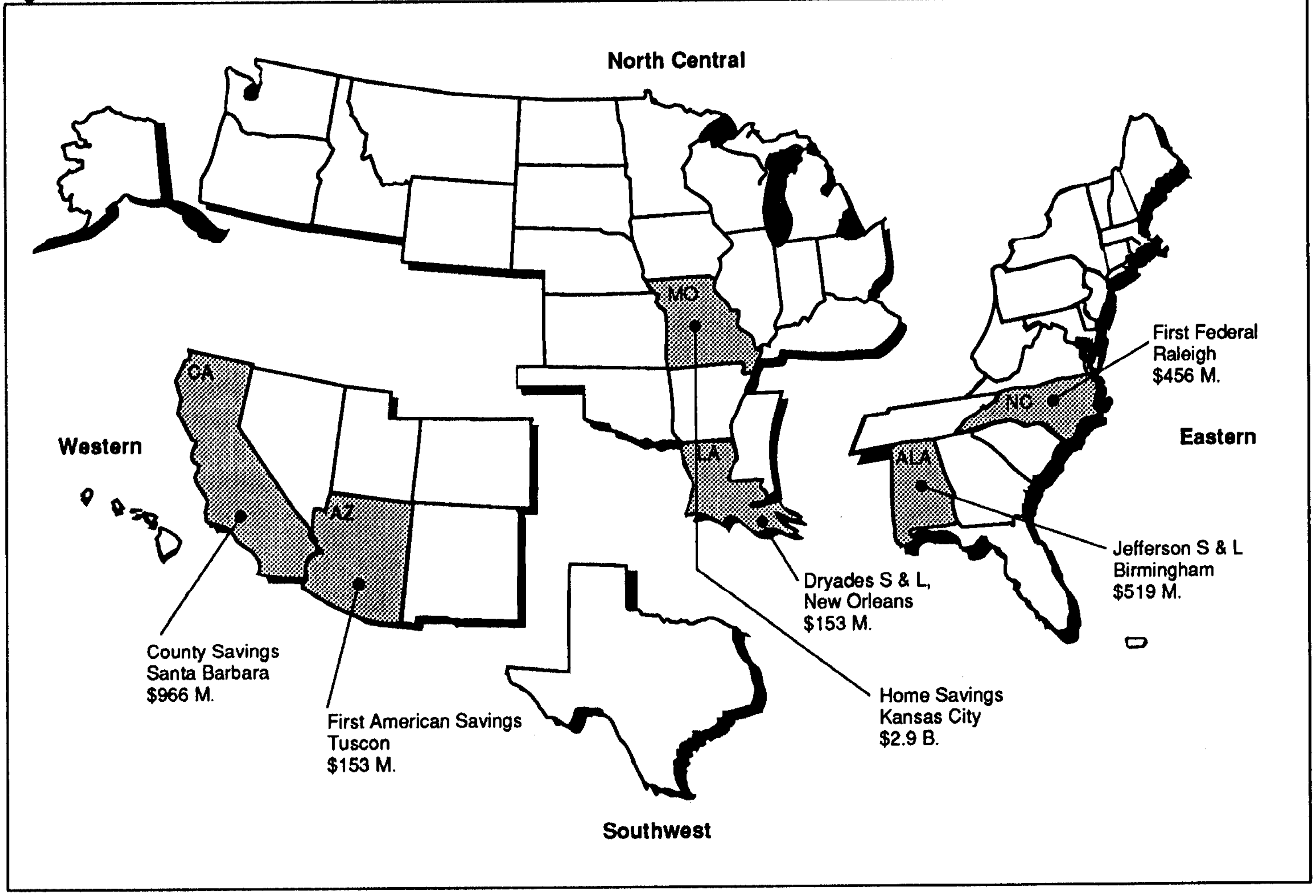
To determine whether AVRS produce reasonable loss estimates for the cost test, we reviewed the applicable asset valuation methodology and RTC directives that were in effect at the time the AVRS we reviewed were done. We met with RTC headquarters officials in Washington, D.C., and regional AVR coordinators and their staffs to determine how RTC implemented its AVR policies and procedures. At the thrifts visited, we obtained information on the condition of the asset files and the contractors' performance from thrift personnel who had knowledge of the assets and worked with the AVR contractors. We also interviewed the contractors who did the AVRS we reviewed.

Our review covered the three RTC regions that were still actively doing resolutions.[7] We judgmentally selected six AVRS—two each from the North Central, Eastern, and Western Regions—to be reviewed in depth. Three of these AVRS were major resolutions (thrifts with greater than $500 million in liabilities), and three were field resolutions (thrifts with less than $500 million in liabilities). We selected AVRS done by different contractors and overseen by different project specialists between June 1991 and

[7]At the time of our review, most of the failed thrifts in RTC's Southwest Region had already been resolved.

January 1992. Figure 1 shows the location of the thrifts whose AVRs we reviewed.

Figure 1: Location of the Thrifts Whose AVRs We Reviewed



Source: GAO analysis of RTC data.

When we began our fieldwork, the RTC IG had ongoing work in the asset valuation area. We met with the IG staff to discuss the objectives and scope of their work and to obtain preliminary information on their findings.

Later, we reviewed their report to determine if the problems we were identifying were also present for the 20 AVRs they reviewed, which were done 6 to 7 months before those we reviewed.[8] The IG reviewed AVR reports and related workpapers for compliance with the applicable policies and procedures, evidence of project specialist review, and mathematical accuracy but did not verify valuation calculations.

At each thrift, in addition to completing the same audit steps done by the IG, we compared a judgmental sample of 286, about 25 percent, of the contractors' asset review sheets with the corresponding asset files and evaluated the contractors' assumptions and conclusions. Our sample was drawn to provide coverage of all asset types so we would be able to test the contractors' application of the AVR methodology for all the assets in the thrift's inventory.

We recognize that our results cannot be projected to the total universe of AVRs done by RTC. However, the high percentage of deficiencies in several categories, as shown in figures I.1 through I.3 in appendix I, are significant and should be addressed by RTC. Also, our results corroborate the IG's asset valuation findings. Since RTC virtually stopped awarding AVR contracts after the IG's report was issued, we were unable to determine whether the actions RTC reported it had taken were effective in correcting the problems identified by the IG.

We did our work between February 1992 and February 1993 in accordance with generally accepted government auditing standards.

Methods, Assumptions, and Conclusions Were Not Explained or Documented

The AVR methodology requires that a narrative section for each of the primary asset categories be included in the AVR report. This narrative should summarize methods, assumptions, and conclusions used to calculate the ERVs. Generally, the narrative sections of the six AVR reports we reviewed did not explain the specific methods used, within the discretion allowed by the methodology or deviations from specified methods, to estimate asset recovery values. Furthermore, there was minimal evidence in the contractors' workpapers to support the approach used.

The AVR methodology defines an asset's ERV as the net present value of the gross sales proceeds, less sales costs, plus interim revenues, less direct expenses attributed to the asset during the disposition period. To

[8]The AVRs reviewed by the IG were completed between July 1, 1990, and May 31, 1991.

standardize the calculation, RTC developed an asset review sheet. However, the AVR methodology does not specify procedures or provide guidance for deriving the dollar values used on this sheet. Thus, a written explanation is needed to assess the reasonableness of these values.

In addition, although the methodology does not specifically require supporting documents for each asset review sheet, RTC officials have told us that such documentation should accompany each review sheet to support the assumptions used to calculate the ERV for each asset. This is an internal control technique that would help RTC ensure that the contractors' assumptions are fully supported. Furthermore, RTC lacked oversight procedures to provide such assurances.

Asset Review Sheets Not Adequately Documented

Most of the asset review sheets in our sample lacked sufficient documentation and justification to allow us to assess the reasonableness or reliability of the estimates. We were unable to verify the information used by the contractors for 64 percent of the 286 asset review sheets we reviewed. In these cases, the contractors apparently used information that we could not locate in the asset files, did not use information available in these files, or referred to information—apparently obtained in conversations with thrift personnel and others—that was not documented in their workpapers.

Again, although RTC's AVR procedures did not specifically require evidence to support key decisions and assumptions made on each asset review sheet, this is an internal control technique that would help RTC ensure that the contractors' assumptions are fully supported. RTC senior Resolutions officials agreed that this was a problem and that the methodology should specifically require documentation to support and justify the assumptions, methods, and conclusions used to calculate the asset valuation methods. The following examples illustrate this control breakdown.

Appraisals

For the six AVRs we reviewed, contractors often used appraisals to estimate the asset sales proceeds. In some cases, however, contractors used outdated appraisals even though more recent ones were in the asset files. For example, in one case the ERV was based on 1975 appraisal information. Three contractors' workpapers had schedules for discounting appraisals based on age or asset type. While these contractors were generally consistent in their application of discounts to individual assets, no evidence to support the selected discounts was included on or accompanied these schedules.

Another contractor appeared to arbitrarily discount appraisals with no explanation or consistency. For example, this contractor discounted appraisals for performing single-family loans using three methods. The appraisal for one of these loans was only a month old and probably did not need to be discounted.

Holding Periods

The holding period is the estimated time an asset will be under RTC control. We were unable to determine whether the holding periods used by the contractors were appropriate for 50 percent of the 286 asset review sheets in our sample. The AVR methodology states that several factors should be considered when estimating an asset's holding period, including its location, type, condition, and the local market. Because of the lack of documentation, we could not tell whether the contractors considered these factors for individual assets, although in some cases it was apparent that they were not taking them into account.

Several contractors selected a specific holding period for a given asset category and applied it to all the assets in that category. For example, one contractor decided that all 1-4 family mortgages and real estate would be held 12 months and all other loans would be held 18 months. Another used a 6-month holding period for all 1-4 family mortgages, second mortgages, and auto loans; a 24-month holding period for land loans; and a 12-month holding period for all other loans.

Both contractors applied these standard holding periods to all the assets in the given categories without taking each asset's unique characteristics into account. For example, one real estate property file had an environmental impact study indicating possible soil contamination from an adjoining lead smelter. However, the contractor used the same holding period for this asset as for other real estate with no adverse conditions. The contractor gave no reasons to justify standardizing the holding periods in this manner.

Expenses

For 107, 37 percent, of the 286 asset review sheets in our sample, the contractors did not give sufficient evidence to justify the "other" expenses used to calculate the ERVs of the individual assets. The AVR methodology stipulates a range of factors to use in calculating standard asset-related expenses that often occur in thrifts, including real estate commissions; asset management fees (appraisal costs, taxes, legal fees); and property management fees (collection of rent, advertising). However, it does not give any guidance on other expenses. For these cases, we were not able to tell how the contractors calculated their expenses.

RTC Oversight Was Not Adequate

While there was some evidence that RTC's project specialists were reviewing the final AVRS submitted by contractors, there was no documented evidence that RTC officials had reviewed the asset review sheets prepared by AVR contractors on the six AVRS we reviewed. The project specialists are to examine the asset review sheets in a timely manner, alert the contractor to any problems, and ensure that the problems are corrected. However, we found no documentary evidence that they had reviewed any of the 286 asset review sheets for the 6 AVRS we reviewed. Also, while the contractors told us that they examine the asset review sheets before giving them to the project specialists, 99, 35 percent, of the review sheets contained no evidence of supervisory review by contractor personnel.

RTC Resolutions officials told us that in response to the IG's recommendation two signature lines were added to the asset review sheet, one for the preparer and one for the RTC reviewer. However, RTC's Vice President for Resolutions told us that actual AVR contracting has come to a virtual standstill since the publication of the IG's report because of a lack of funding. Consequently, they have not yet used the new form on a contract AVR.

Also, 82 (29 percent) of the asset review sheets in our sample had numbers that were incorrectly transcribed from the asset files, 46 (16 percent) had incorrect calculations, and 13 (5 percent) had rounding errors. In one case, the current book value of a loan was recorded as $23,912 rather than $239,115 as shown on the thrift's trial balance. The contractor used the erroneous figure to estimate the loan's current market value.

Had the project specialists and contractors reviewed the asset review sheets, we believe that the problems noted here and in appendix I could have been reduced or eliminated. RTC's Vice President for Resolutions told us that project specialists are assigned to each AVR case. He said these individuals are to be onsite continuously during the AVR and basically act as a coordinator and reviewer during the entire process. He told us that admittedly documentation requirements to support this form of audit/control at the time the AVRS we reviewed were prepared were "somewhat lacking."

RTC Could Make Greater Use of Actual Asset Recovery Data

Although the AVR methodology calls for the use of actual sales data whenever it is available, RTC has not been providing this data to its AVR contractors for use in asset valuations. The contractors we interviewed told us that they were unable to obtain actual asset recovery rate information from RTC to use in the AVR process. One contractor told us that the RTC regional sales center refused to provide this information when he requested it. Resolutions officials agreed that this was a problem and that contractors should have access to this information. They told us that they have been working with asset management on this issue and that at least two of the regional sales offices were providing such data upon request.

Still, an official from RTC's Office of Research and Statistics told us that they were reluctant to give contractors actual sales recovery data because they felt that these data would give contractors an incorrect benchmark against which to measure the value of a conservatorship's assets and might be used improperly by contractors. Since the longer a thrift stays in conservatorship the lower the quality of the remaining assets, RTC does not believe that the recovery rate data are representative of the remaining assets. While we agree with this observation, we do not believe this justifies not sharing the data. Knowing that asset quality continues to deteriorate over time, contractors can adjust the estimated value of remaining assets accordingly.

RTC has sold thousands of assets in nearly all categories and has data showing its actual recovery rate experience on asset sales. RTC should consider making greater use of this available actual asset recovery data. The AVR methodology requires contractors to use these data when it is available, but RTC has usually not provided actual recovery data to contractors, even when they have requested it. Use of actual recovery data in the asset valuation process, if properly used, would help RTC assure itself that asset valuations are reasonable.

Also, RTC could use actual asset recovery data as a reality check or oversight tool to test the reasonableness of AVR results. We believe that having a comparative basis to use in monitoring AVR contractors' performance is an effective internal control mechanism. Using comparative data to evaluate the adequacy and reasonableness of AVRs would also serve the decision-makers in discharging their responsibilities to ensure that the cost test identifies the least costly resolution method.

Actions Being Taken by RTC to Correct Documentation and Review Problems

The AVRs reviewed by us and the IG were all done many months ago. At the closeout conference on this assignment, RTC's Vice President of Resolutions told us that, as a result of the IG's report and our work as well as some of their own initiatives, RTC has instituted several requirements that he feels will improve RTC's documentation and review standards and the AVR process in general when RTC resumes AVR contracting.

In addition to adding a signature line to each asset review sheet to document and provide evidence of proper review, an AVR report checklist is being developed for project specialists to use in reviewing AVRs. The latest version of the draft checklist is dated February 4, 1993. This checklist is extensive and requires the project specialist to answer many of the same questions that were included in the audit guidelines we used to assess the adequacy of the six AVRs we reviewed. It mandates a comprehensive review of the AVR process in general and the contractors' work specifically. A few of the areas addressed in the checklist are such requirements as

- review of asset review sheets (supported by sign-off on the actual sheet);
- cross-checking the AVR report with the thrift's bid package, tying in individual categories of assets and liabilities, where appropriate;
- specific requirements that each type of asset valuation be supported by the narrative comments as well as a description of various rates used and assumptions made; and
- documenting and explaining when valuations are made other than in accord with the required AVR methodology.

RTC's Vice President for Resolutions told us that while he felt that the majority of the checklist requirements were being followed previously, although not documented, the requirement for certification and documentation should improve the overall process. He said that as they move forward, assuming they will be able to resume the AVR contracting process to prepare thrifts for resolutions, RTC officials believe the complete implementation of this new checklist as well as standard requirements for completion will address the concerns expressed by us in this report as well as those in the IG's report.

ARES Did Not Meet Objectives

RTC's objectives in developing ARES were to standardize the calculation of asset ERVs and reduce the redundancy that existed in RTC's various asset valuation processes by sharing common information. To do this, RTC intended to use ARES during the initial AVR, which is done early in a thrift's conservatorship, to establish the ERVs for the thrift's assets and create an asset valuation database. RTC anticipated that at resolution the database could be easily updated using new assumptions and current economic conditions. The database was also to be available for other asset valuation needs, such as determining the ERVs for assets placed under asset management and disposition contracts.

RTC has experienced significant problems developing ARES. During the period of our review the system had not been able to fully realize the design objectives. Although RTC had been trying to use ARES in the AVR process, AVR contractors were not able to get the program to operate properly, and RTC had not given ARES training to its personnel and contractors. Also, ARES had not been used early in conservatorships to create the envisioned asset valuation database. As a result, ARES did not work as anticipated or support the needs of AVR teams.

ARES Has Not Been Adequately Tested and Evaluated

RTC's Eastern Regional Office began developing ARES in August 1990. A year later, RTC headquarters took control of the system's development and introduced it at the annual AVR contractors' meeting in September 1991. Because ARES did not work properly, contractors reacted negatively. In response to contractors' concerns, RTC decided to field test the system and correct its deficiencies before national distribution.

The program was not tested in a controlled field situation. Rather, RTC headquarters tested ARES using a limited number of fictitious assets and determined that the deficiencies were resolved. ARES was then distributed to RTC's field offices. However, RTC did not give formal ARES training to either the contractors or RTC personnel involved with AVRs because they believed that ARES was user friendly. They concluded that the demonstration given at the annual meeting would be a sufficient introduction to the program.

Contractors Experienced Major Problems Using ARES

After being introduced at the annual meeting, ARES was used at two thrifts in the Eastern Region. Both contractors reported major problems with the program, including

- difficulty entering data;
- inability to perform functions or generate information without using Lotus 123 or a similar program;
- inability to print files, merge files, and generate tables necessary to write final reports; and
- loss of data and program failure.

Other contractors experienced similar problems. In spite of these problems, RTC continued to use the program.

RTC Continues to Develop ARES

In March 1992, we met with RTC's Chief Financial Officer (CFO) to discuss our concerns and observations about ARES. We told him that, on the basis of our review of AVRs done using ARES, we did not see sufficient benefit in continuing to develop the program. Other RTC officials attending the meeting said they were aware that regaining regional staff and contractor confidence and cooperation would be difficult because the program had never operated as intended. We were told that RTC formed a task force to address these problems and improve the program.

The CFO estimated that RTC would need at least another 12 months to complete ARES development and field test the program in a controlled environment. He added that in this time frame RTC resolutions would be nearly completed and the need for ARES negated. Nevertheless, the task force continued its development and testing of ARES.

To address our concerns about the lack of testing of ARES, the task force scheduled two field tests to ensure that the program worked properly. The first test was to identify additional changes and problems that might still need to be fixed. It was scheduled for July 13, 1992, but was never done. Instead, RTC proceeded with the second test, which was done from August 3 through 6, 1992.

We participated in this test. During the test the program still did not function properly, and many of the prior problems had not been corrected. We and others who had previous experience with the program and were knowledgeable about the AVR process had problems entering data into the program and accessing the mark-to-market model. The efficiency of the AVR process was still not improved by using ARES because the asset review sheets were completed by an analyst before they were entered into the program, and the tables needed for the final AVR reports could not be generated. These deficiencies negated the value of using an automated tool in the valuation process.

ARES Accepted but Not Yet Fully Tested in Operation

On August 25 and 26, 1992, RTC completed the user acceptance test for ARES with RTC employees doing the testing. This final test was to be done in a testing environment that simulated the operational conditions ARES would be used in to test the application software and user procedures. The test was to enable RTC to review ARES functionality and technical features to ensure that they complied with the approved business and technical requirements and expected performance. According to RTC's acceptance report, the test results showed that all functionality requirements were met.

However, on the basis of our review of the ARES version 3.0 user acceptance test plan, we found weaknesses that lead us to question the validity of the test. For example, contractor personnel—the primary user of ARES—were not included in the test, even though it was one of the test requirements. We believe that contractors who are familiar with ARES and have used it on actual AVRs should have been included because they are aware of ARES' deficiencies, could measure the improvements, and provide input based on their knowledge.

Furthermore, only four assets were used for the test. This did not constitute, in our opinion, an adequate sample on which to judge ARES' more complex functions in an environment that simulates normal operational conditions. While test personnel reported no problems entering the data into the computer or generating the reports with the small sample used in this test, we and contractors on the earlier field tests experienced problems when large numbers of asset review sheets were entered on more than one computer and had to be merged before generating reports. We were also unable to determine whether RTC attempted to merge data from different disks. This was a critical defect in the earlier versions of ARES. We feel that this important function should have been tested.

Finally, although RTC considers ARES fully functional, it has not been operationally tested by AVR contractors at a thrift on an actual AVR because RTC has not contracted for AVR work since the system was accepted. Until the contracting is resumed, RTC cannot assure itself that all the weaknesses and problems previously identified by contractors have been corrected.

Conclusions

Our review and the IG's work raised a number of concerns about the adequacy of RTC's internal control over the AVR process. Both we and the IG found inadequate documentation of the level and extent of review that RTC officials exercised in assessing the adequacy of the asset review sheets supporting asset valuation estimates. As a result, RTC cannot ensure that asset valuations resulting from this process are reasonable and has been permitting and accepting poor quality work from some of its AVR contractors.

Implementation of the IG's AVR recommendations when AVR contracting is resumed should provide a framework for improving the process. However, we believe RTC will still need to ensure that its AVR process methodology is implemented properly and consistently so that the desired improvements actually occur. To do this, RTC needs to strengthen its oversight of the preparation of both the asset review sheets and the final AVR reports to ensure that (1) its methodology is being applied properly, (2) the assumptions used to estimate the asset recovery values are adequately documented, and (3) any deviations from the methodology are justified.

Further, RTC has not been sharing and taking full advantage of available pertinent asset recovery data in preparing valuation estimates and assessing AVR contractors' work. We believe that RTC could improve the process by making greater use of other available sources of asset recovery data to improve the quality of the estimates and to assess the reasonableness of the AVRS.

Finally, we are not convinced that RTC's vision for ARES has been successfully translated into a fully functional operating system. We do not believe that the results of the user acceptance test, due to the limited scope of the test and the exclusion of AVR contractors who will use the program, demonstrate that ARES will meet user expectations. Therefore, we believe it is essential that RTC closely monitor the use of ARES to ensure that the program's problems have been corrected and that the program will operate as intended.

Recommendations

We recommend that the RTC's President and Chief Executive Officer

- schedule periodic management reviews of the AVR process to ensure that RTC staff and contractors are complying with applicable policies and procedures and the AVR methodology in (1) making asset valuation reviews, (2) preparing individual asset review sheets, (3) preparing the final AVR report, and (4) monitoring these activities;
- revise the AVR methodology to specifically require documentation for each asset review sheet to support and justify the methods, assumptions, and conclusions used to calculate asset valuation estimates;

- give AVR contractors access to actual asset recovery information so that they can use this information in estimating the probable market value and potential loss on a thrift's assets and, internally, use this information for comparison purposes to assess the reasonableness of AVR results; and
- closely monitor the implementation and use of ARES to ensure that the program is operating as intended.

Agency Comments

RTC officials commented informally on a draft of this report. RTC's Vice President of Resolutions said that he would agree that in several instances, at the time of our review and considering the AVRs reviewed, there was evidence of the lack of formalized controls and documentation that would provide for desired audit trails. However, as a matter of general practice, he believed that even at the time these AVRs were prepared there were substantial requirements that were followed but inadequately documented to allow for comprehensive third party review. He also asked that the actions RTC was taking to implement the IG's recommendations be recognized in this report. A section was added to this report providing information on actions being taken by RTC in this regard.

On the issue of providing contractors with actual sales recovery data, RTC reiterated its position that it was reluctant to provide these data to contractors. RTC officials felt that these data could be misleading since the longer a thrift stays in conservatorship the lower the quality of the remaining assets. We do not disagree with this observation, but the fact remains that RTC's AVR methodology requires such data to be considered in valuing the assets of a thrift.

RTC officials also made various other suggestions and comments that have been incorporated in this report where appropriate.

As agreed with your office, unless you publicly release its contents earlier, we plan no further distribution of this report until 21 days from the date of this letter. At that time, we will send copies of this report to other interested congressional members and committees, the Chairman of the Thrift Depositor Protection Oversight Board, and the President and Chief Executive Officer of RTC. We will also provide copies to others upon request.

The major contributors to this report are listed in appendix II. Please contact me on (202) 736-0479 if you or your staff have any questions concerning this report.

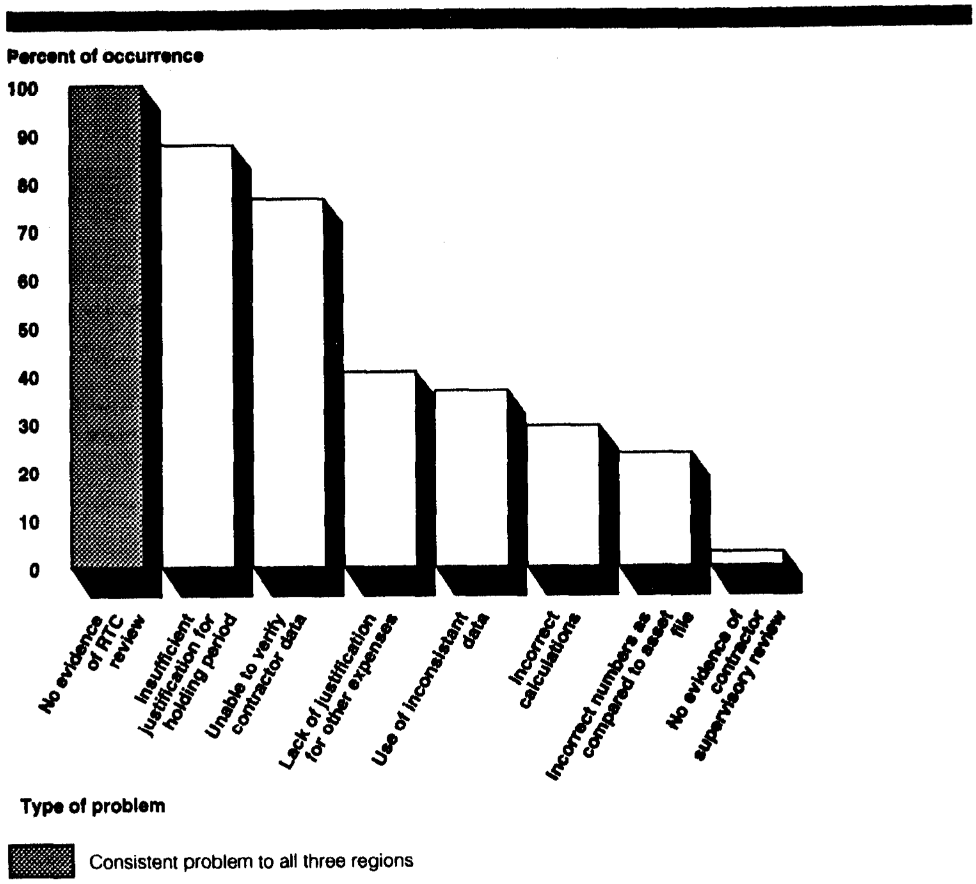
Sincerely yours,

Gaston L. Gianni

Gaston L. Gianni, Jr.
Associate Director, Government
Business Operations Issues

Asset Review Sheet Problems

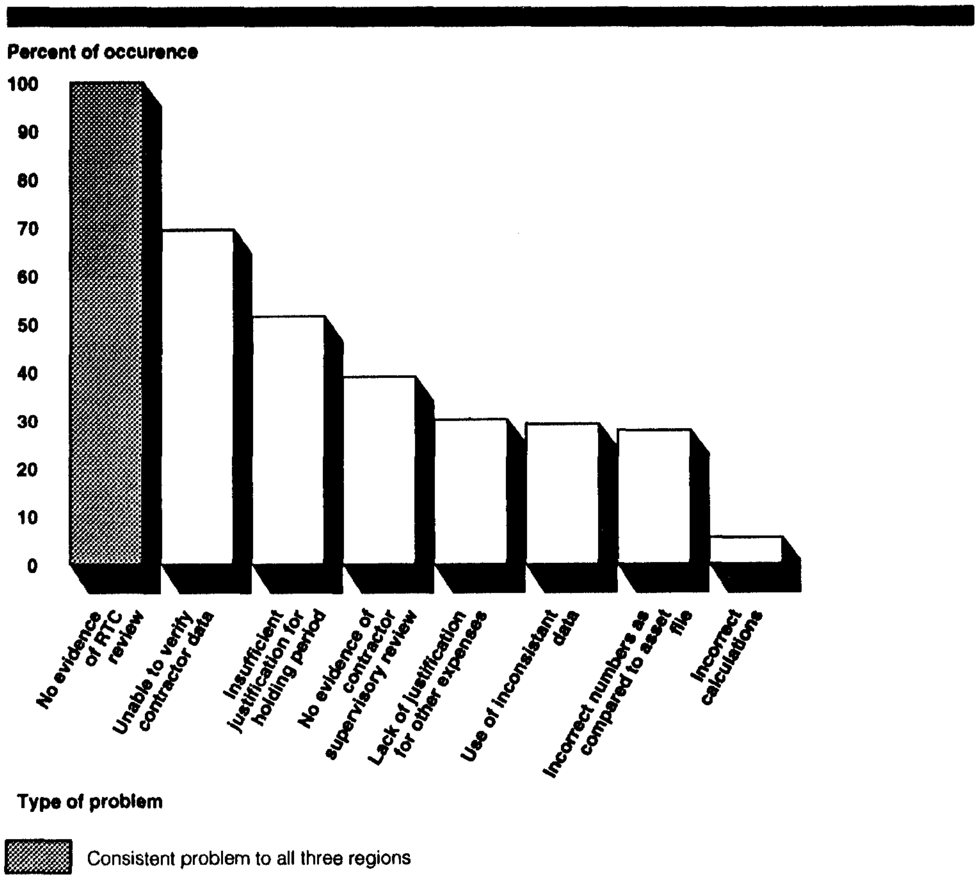
Figure I.1: Eastern Region Asset Review Sheet Problems Listed by Order of Severity



Note: Data based on 106 asset review sheets examined by GAO.

Source: GAO analysis of RTC data.

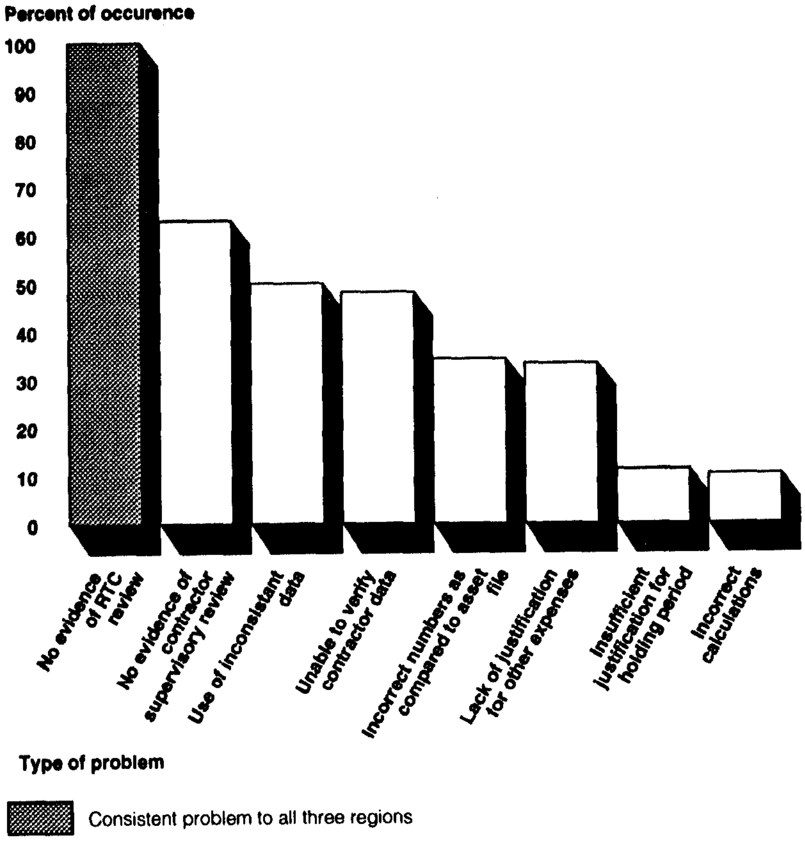
Figure I.2: North Central Region Asset Review Sheet Problems Listed by Order of Severity



Note: Data based on 72 asset review sheets examined by GAO.

Source: GAO analysis of RTC data.

Figure I.3: Western Region Asset Review Sheet Problems Listed by Order of Severity



Note: Data based on 108 asset review sheets examined by GAO.

Source: GAO analysis of RTC data.

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