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RTC Asset Management: Contracting Controls Need to Be Strengthened

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Senate Committee on Governmental Affairs

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the Resolution Trust Corporation's (RTC) contracting practices.

Over the years, the government has been plagued by serious breakdowns in its internal control and financial management systems. Unless something more is done to correct the material deficiencies in management information and accounting systems and material weaknesses in internal controls, major losses of federal funds and the collateral fraud and abuse will continue. That fact, based on work we have done over the years in many agencies, and agency assessments of their own problems in response to the Federal Manager's Financial Integrity Act, makes it critical that RTC operate its contracting activities well.

From RTC's inception, we have been concerned about its vulnerability to fraud, waste, and abuse because of (1) the unprecedented dollar value of the assets under RTC's control; (2) heavy reliance on a large number of private sector contractors, which creates an inherent vulnerability to fraud, waste, and abuse; and (3) weak management information systems and oversight capabilities at this point in time. For these reasons, in January 1990 I cited RTC as 1 of 14 highly vulnerable federal programs.

RTC, to its credit, has proceeded somewhat cautiously in the contracting area. It has tried to take the time to adequately develop policies and procedures that its decentralized staff must follow in developing contracts with thousands of different companies. On the other hand, the volume of assets that RTC must deal with continues to increase. Thus, the corporation faces a real dilemma. It must try to develop and implement good policies, procedures, and practices while at the same time produce results in terms of properly managing and quickly disposing of these assets. From our perspective, it is absolutely critical that RTC have adequate policies, procedures, and internal controls before embarking upon a massive contracting operation.

The number of institutions and the high dollar value of the assets under RTC's control provide an indication of the enormous scope of RTC's management responsibilities. From August 1989 through June 1990, RTC took into conservatorship 454 thrifts with $244 billion of assets. As of June 30, 1990, RTC had resolved 207 thrifts and still controlled $168 billion of assets, including real property with a book value of about $16 billion representing over 40,000 properties. By comparison the former Federal Savings and Loan Insurance Corporation (FSLIC) and Federal Asset Disposition Association were only managing about $10 billion in total assets in 1988.

PROGRESS IN DEVELOPING SOUND CONTRACTING ENVIRONMENT

Reliance on contractors to carry out a major portion of the agency's mission makes it essential that RTC have effective management control over the contracting process. This requires (1) an appropriate organizational structure for selecting contractors and monitoring their performance; (2) sufficient numbers of competent personnel to award and monitor contracts; and (3) an internal control system to safeguard assets against waste, loss, unauthorized use, and misappropriation and ensure that the government gets what it pays for under contracts.

In the 13 months since RTC's inception, progress has been made toward developing a management structure to mitigate its vulnerability to fraud, waste, and abuse. Actions include establishing a decentralized organization, hiring staff, and developing policies and procedures. However, more needs to be accomplished in these areas if RTC is to have effective management controls over the management and disposition of assets.

Structure

Conceptually, the organizational structure should, if properly implemented, provide management with the overall framework for planning, directing, and controlling the contracting operations. This includes lines of authority and responsibility, communication channels, reporting relationships, and separation of authority. The structure also affords provisions for supervision, training, and motivation of employees.

RTC has developed a highly decentralized organizational structure with delegations of authority to its regional staff. Headquarters asset management activities are organized into three major functions--marketing, asset and contract management, and disposition. A field structure consisting of 4 regional offices and 14 consolidated offices has been set up to do much of the work but is not yet fully staffed.

Communication between the field offices and headquarters is still evolving. What is happening is that the RTC approach to dealing with contracting and other issues is evolving through responses to specific problems that arise. As questions arise in the regions on how to deal with a particular issue, calls are made to headquarters officials. The issues are discussed and eventually positions are taken. It is natural in such cases for there to be some concern that decisions are not made as quickly as everyone would like. But given RTC's massive job, and the intense public scrutiny it knew it was going to face, it is understandable that RTC has taken some time to resolve issues. We would expect that the corporate operating procedures should be emerging as RTC gets its policies and procedures in place and its staff gets experience.

Since this critical area is still evolving, it warrants continued oversight to ensure that the appropriate organization is developed and effectively implemented.

Staffing and Training

It is critical that RTC be staffed with managers and employees who maintain and demonstrate (1) personal and professional integrity, (2) a level of skill necessary to help ensure effective performance, and (3) an understanding of the internal controls being used to effectively discharge their responsibilities. These elements are vital to the effectiveness of management's control over the contracting process because (1) RTC's mandate is to contract out as much work as possible; and (2) much of RTC's staff is either new to the government or from the Federal Deposit Insurance Corporation (FDIC) where the normal practice was to do its own asset management and disposition rather than working through contractors.

Overall, RTC has onboard about 59 percent of its planned 6,200 staff. As of July 20, 1990, the staffing levels at the consolidated sites, where most of the asset contracting and monitoring work will take place, varied greatly, from about 74 percent of planned capacity in Kansas City, Missouri, to 37 percent in Rolling Meadows, Illinois. While regional office staffing ranged from a low of 40 percent of planned capacity in the Western Region and a high of 64 percent in the Central Region, headquarters had reached 57 percent of its planned 672 staffing level.

In April RTC established a Training Task Force, which was responsible for assessing the overall training needs and identifying where training should be strengthened. RTC is now in the process of developing a training program for its staff based on preliminary Task Force recommendations. In the interim, RTC has been holding a series of regional seminars to orientate staff to RTC's operating procedures.

Internal Controls

RTC's progress in implementing internal controls has not been as good as we would like. RTC's internal control system should include, at a minimum: (1) policies, procedures, and other directives to guide and assist staff in carrying out their duties; (2) separation of duties to reduce the risk of error, waste, or wrongful acts or to reduce the risk of their going undetected; (3) adequate supervision of personnel; and (4) information systems to capture, record, summarize, and report results of operations. Information should be presented in financial and related quantitative terms so managers can measure whether or not the policies and procedures they have promulgated are having the desired and intended effect on achieving their goals. While RTC has developed some essential controls, as we shall now discuss, many have not yet been tested and others need additional development.

Contractor Registration

Defined policies and procedures will be especially important for RTC staff to effectively implement its regulations for contractor qualification and performance standards. Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) provisions and RTC regulations establish minimum standards of competence, experience, and integrity for contracting with RTC. Those standards bar individuals or firms from contracting with RTC that have been convicted of a felony; have been barred from the banking industry by any federal banking agency; have caused substantial losses to a federal deposit insurance fund; are currently in default on an obligation to the FDIC, FSLIC, or RTC or an insured depository institution; or have demonstrated a pattern or practice of defalcation regarding obligations to insured depository institutions.

In February 1990, RTC adopted a rule on ethical standards for firms seeking to provide services to RTC. The rule, which is applicable to asset managers, real estate brokers, appraisers, and others, requires them to register with the agency and self-certify that they and their related entities meet these standards.

Further, firms are to submit other information to establish their capability, expertise, and service area. This information is used to determine whether the firms meet minimum requirements and standards of fitness. RTC may use its discretion to deny registration in questionable cases. Any firm that cannot certify that the mandatory ineligibility conditions do not exist <u>must</u> be denied registration.

As of July 31, 1990, 19 firms had been disqualified. In addition, 18 firms that had not met certain discretionary standards specified in implementing regulations were granted waivers. Six of them were granted contract waivers, and 12 of them had discretionary qualifications waived to permit their registration.

The self-certification process has been useful to RTC for identifying a pool of potentially qualified contractors. But it does not eliminate the need for a thorough pre-award examination of the background and qualifications of contractors, principals, officers, and the key personnel to be assigned to a specific contract. RTC's Office of Investigations carries out the pre-award investigations of such personnel on the basis of the data provided by the proposed contractor as well as information developed by the investigating officials themselves.

To date, only a few asset management contracts have been awarded under the system. As the volume of awards increases, it is essential that RTC controls provide effective oversight of how well the pre-award investigations are done.

Asset Management Controls

Another control that RTC has developed is a Standard Asset Management and Disposition Agreement. The agreement, released in June 1990, in most instances will be executed with a contractor for the management of a pool of like assets in a given geographical location. The agreement requires contractors to prepare a business plan for the management and disposition of the assets, provide asset management services, and sell the assets.

A key aspect of this agreement is a fee structure that creates incentives for RTC's contractors to maximize proceeds from the sale of assets. Generally, the contractor's compensation will consist of three different components: (1) a management fee, (2) a disposition fee, and (3) an incentive fee. The management fee is compensation for managing the assets. The disposition fee varies depending upon how well the contractor either matches, exceeds, or falls short of meeting the expected recovery value of the asset. Both the management fee and the disposition fee are evaluated separately as part of the contractor selection process. The incentive fee rewards the contractor for speed in selling the assets. That is, the sooner an asset is sold the higher the payment.

RTC is just starting to place assets under management contracts. By December 1990, it expects to have about $30 billion of the $40 billion of assets held in receiverships as of June 30, 1990, managed by contractors. Thus, RTC's controls must provide for carefully monitoring and evaluating the management agreement to determine if it is achieving RTC's goals.

<u>Contract Monitoring</u>

The responsibility for monitoring asset management contracts will rest primarily with RTC staff in the consolidated field offices. However, RTC has not set up a viable contract administration structure to effectively monitor the execution of its contracts. We found no detailed instructions, procedures, or other guidance to help regional personnel monitor the activities of contractors.

On May 15, 1990, RTC issued its <u>Asset Management and Disposition Manual</u>. This manual is to be used by all involved in the asset management and disposition process, including, but not limited to, those contractors employed under the Standard Asset Management Agreement contract. It provides a set of general policies and guidelines to standardize and simplify RTC's asset management responsibilities.

The only guidance in the manual addressing the issue of contract monitoring is the following paragraph:

> "E. <u>Oversight and Evaluation</u>
>
> RTC staff will provide continuing oversight by monitoring the activities of contractors. Firms found to be performing below an acceptable level will be notified, informed where they are deficient, and placed on probation. As long as a firm remains on probation, they will not be offered new opportunities to work for the RTC. If, within a reasonable period of time, the firm is not performing at an acceptable level, existing contracts will be terminated."

During our work in RTC's Southwest Region, we found that neither the regional office nor the two consolidated offices we visited had implemented plans for monitoring contractor performance. Officials at these offices told us that the broad guidance distributed by headquarters was insufficient for field application. Further, in the Western Region, the regional contracting staff said they had not developed any local policies, procedures, or practices to implement the contract monitoring requirement.

RTC estimates that about 1,700 RTC employees will be involved in monitoring contract performance, and many of these individuals will be new to RTC and the government. Therefore, we believe more specific guidance will be necessary to ensure that contracts are monitored in a consistent and effective manner by RTC's decentralized organization.

PROBLEMS IDENTIFIED IN OTHER ASSET DISPOSITION AND EARLY RTC WORK

Over the past several years, the federal government has managed and disposed of a wide range of assets under the

-- seized and forfeited assets programs of the Marshals Service and the Customs Service;

-- loan asset sales programs of the Farmers Home Administration and the Departments of Education, Housing and Urban Development, and Veterans Affairs; and, of course,

-- failed bank and thrift assets disposal programs of FDIC and FSLIC.

Our work has shown that these programs often did not require the appropriate information from contractors or have good contract monitoring for sound management. Both of these controls will need to be present and working effectively for RTC to ensure that contractors are providing the best possible services and the interests of the government and the public are protected.

On the basis of our previous asset management and early RTC work, we have identified the following problems RTC must watch for and avoid if possible:

-- <u>Net proceeds from asset sales not calculated</u>. Our past work in the seized assets programs showed a lack of adequate financial information for managing the programs well. We recently reported that Department of Justice and Customs Service managers did not know how much money was recovered (after costs) from the sale of forfeited noncash assets managed by government contractors.

-- <u>Good performance measures difficult to define</u>. Our previous work on failed banks and thrifts showed that developing good performance measures for monitoring contractor liquidation activity can be difficult, because sales volumes and asset prices are affected by asset quality and prevailing economic conditions. RTC has not yet developed the asset management performance measures needed to determine satisfactory contractor performance, nor has it issued guidance to tell field people how to use the specific contract monitoring tools. Consequently, it is very difficult at present for RTC to monitor contracts, evaluate performance, and hold contractors accountable. For example, RTC's Interim Contracting Activity Reporting System provides RTC staff with overall statistical and status information on the contract award process but does not provide performance measurement information to track contractor progress.

-- Insufficient management information. We also reported in July 1990 that RTC has been making a number of automation decisions without establishing the strong leadership and comprehensive information resources management planning needed to effectively manage its information resources.[1] This increases the risk that the information technology RTC develops or acquires may not adequately support its mission objectives. RTC's individual information systems are not integrated and do not allow access to summary level information across the organization. Additionally, RTC has experienced an array of data accuracy problems in its national real property owned database.

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[1] Resolution Trust Corporation: Stronger Information Technology Leadership Needed (GAO/IMTEC-90-76, July 23, 1990).

RTC is taking steps to improve its information systems. Subsequent to our July 1990 report, RTC created an Office of Corporate Information and appointed a senior information resources manager to lead the office. This office will be responsible for the overall development and administration of the agency's information systems. RTC also has plans to improve the quality of the real estate inventory by requiring regions to verify the accuracy of the inventory's data. We will monitor their progress carefully.

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In view of the unprecedented federal contributions to the thrift crises, the magnitude and value of the assets being managed by RTC, and RTC's heavy reliance on a large number of private sector contractors, it is extremely important that RTC have effective management control over the contracting process. RTC has made progress but needs to do more to ensure that it has an effective management structure in place to manage the assets under its control, a full cadre of well-trained staff, sound contracting procedures, and effective controls.

This concludes my prepared statement, Mr. Chairman. We would be pleased to respond to questions.