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RESOLUTION TRUST CORPORATION

Funding, Organization, and Performance

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Resolution Trust Corporation:
Funding, Organization, and Performance

SUMMARY OF STATEMENT BY
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Without new funding, RTC cannot resolve the failed thrifts for which it is responsible under FIRREA. RTC resolution efforts have been hampered by repeated funding disruptions, and RTC has now been without loss funds since April 1992. Funding disruptions add to the overall cost of the thrift clean-up because thrifts under RTC's control continue to post losses. As a result, GAO believes that RTC should receive the funds needed to resolve failed thrifts.

As of December 31, 1992, RTC had disposed of assets with a book value of about $330 billion, or about 75 percent of the assets that have come under its control. Although RTC has sold a large volume of assets, it still has an enormous and difficult job ahead. RTC's remaining inventory had a book value of approximately $103 billion as of December 31, 1992, most of which was considered hard to sell.

RTC's disposition efforts have primarily emphasized book value reduction, although FIRREA requires that RTC pursue a goal of maximizing recoveries on its asset sales. Many of RTC's program objectives emphasize reducing asset inventory rather than maximizing recoveries. GAO believes that RTC must review its information and reporting needs to maximize returns on its hard-to-sell assets. RTC lacks information on holding costs, holding periods, revenues, net proceeds, and sales method used. If such data were available, RTC could more effectively manage its disposition program. RTC also could better evaluate the effectiveness of various sales methods, target assets for specific programs, reduce holding costs, and increase asset net recoveries.

In creating RTC, Congress provided it with the authority to establish its own procurement rules and procedures. Unfortunately, RTC has consistently failed to follow its own contracting procedures, resulting in millions of dollars of increased costs. Most recently, serious contracting problems similar to those that existed with RTC's Western Storm project were repeated at HomeFed Savings Bank in San Diego, California. GAO found noncompliance with contracting procedures, poor planning, administration, and oversight problems.

GAO believes that to prevent further contracting abuses, RTC's top management needs to take immediate action to ensure that its staff comply with RTC's contracting policies and procedures and that major contractors have adequate internal control systems.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the performance of the Resolution Trust Corporation (RTC) and the critical policy and program questions confronting efforts to clean up failed thrifts and dispose of their assets.

In 1989, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) was enacted in response to a major financial crisis. FIRREA abolished the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation (FSLIC) and established RTC to resolve hundreds of failed thrifts. Under existing law, RTC has resolution authority--the authority to take control of thrifts placed in receivership or conservatorship--through September 30, 1993. RTC has disposition authority--the authority to dispose of assets and liabilities of thrifts placed into receivership or conservatorship--until it ceases operation no later than December 31, 1996. Remaining assets and liabilities will be transferred to the FSLIC Resolutions Fund, which is managed by the Federal Deposit Insurance Corporation (FDIC).

As you know, Mr. Chairman, we recently released a series of high-risk reports detailing our concerns with the federal program areas that are most vulnerable to waste, fraud, and abuse because of weaknesses in internal control systems or in financial management systems. One of those reports focused on RTC.[1] In it we discussed a number of long-standing weaknesses in RTC's asset disposition strategies, contract planning and oversight, information systems, and financial management efforts. These weaknesses reduce the amount of money RTC recovers through asset disposition and increase the costs borne by taxpayers to resolve the thrift crisis.

Today, at the request of the Subcommittee, I will build on the issues presented in that report and focus on three broad topics. First, I will discuss the most immediate issue facing Congress as it seeks to complete the thrift clean-up; the need to fund RTC and the Savings Association Insurance Fund (SAIF). Second, I will discuss the need for careful planning for moving resolution responsibilities from RTC to FDIC. Finally, I will comment on RTC's overall operational performance, with particular emphasis on the need for RTC to focus on maximizing recoveries and to strengthen its internal controls over contracting.

FUNDING RTC AND SAIF

RTC receives and uses funds for two different purposes: to pay for losses and to provide working capital. For each resolution it performs, RTC calculates the amount it will have to pay to cover depositor claims and then estimates how much of that cost

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[1]Resolution Trust Corporation (GAO/HR-93-4, Dec. 1992).

it will recover from the sale of the failed institution's assets. The amount expected to be recovered is considered working capital and is borrowed from Treasury's Federal Financing Bank (FFB). The remainder--that portion not recoverable--is a loss to RTC and must be covered with loss funds. Currently, RTC's only available source for loss funds is to receive an appropriation from Congress.

Working capital provides the funds necessary for RTC to purchase assets from failed institutions and to manage and maintain them in receivership until sale. Working capital borrowing must be supported by the estimated recovery value of receivership assets. RTC reestimates asset recovery values quarterly using a statistically valid sampling methodology and, if necessary, decreases or increases working capital borrowing based on the results.

RTC's estimates are subject to significant uncertainties because of the nature of the assets remaining in RTC's receiverships and the continuing weaknesses in the real estate markets, particularly in certain geographic areas. RTC may find that hard-to-sell assets will return less than estimated when they are sold, and RTC may have to use additional loss funds to repay some portion of FFB borrowing.

Through March 5, 1993, RTC closed 654 institutions and covered $196 billion in deposit liabilities using a combination of loss funds, working capital, and asset transfers at the time of resolution. As of that date, RTC had used $85 billion in loss funds and had $36 billion outstanding in FFB borrowing. At its highest level, RTC working capital borrowing reached $64 billion on November 30, 1991. Net RTC repayments using asset sales proceeds transferred from receiverships have totaled $28 billion.

RTC Funding Needs

Although RTC has closed 654 institutions, its resolution efforts have been hampered by repeated funding disruptions. RTC has run out of loss funds and has generally had to stop resolving thrifts three times since it was established. Most recently, RTC had to return $18.3 billion in loss funds to the Treasury because it did not obligate the funds before its appropriation expired on April 1, 1992. Lacking funds, RTC has closed only 14 institutions since the April deadline. As a result, thrifts under RTC's control continue to post losses that cause the overall cost of the cleanup to mount.

Without a new appropriation, RTC cannot resolve the failed thrifts for which it is responsible--those placed in conservatorship through September 30, 1993. Currently, RTC has

83 institutions with $46 billion in assets in conservatorship. Recent estimates from the Office of Thrift Supervision (OTS) suggest that an additional 35 institutions with $30 billion in assets will probably fail and be transferred to RTC before the September deadline.

In addition, OTS has identified 52 institutions with $19 billion in assets that are likely to fail within the next 6 to 12 months. Depending on when these institutions are placed in conservatorship or receivership, they will go to either RTC or the Savings Association Insurance Fund (SAIF) for resolution. Given the uncertainty concerning resolution responsibility for this last tier of thrifts, we believe the most prudent funding approach would be to appropriate to RTC the estimated funds needed to resolve all 170 projected failures. To help ensure that SAIF is adequately funded, it also would be prudent for the appropriation to provide that RTC transfer funds to SAIF when and if RTC determines that the entire appropriation is not needed to resolve institutions for which RTC is responsible.

The Thrift Depositor Protection Oversight Board expects the cost of resolving the 170 projected failures to be between $17 billion and $24 billion. In addition, the Oversight Board estimates that another $4 billion could be needed to complete the resolution of the 654 thrifts closed through March 5, 1993. These funds would cover higher than expected losses when assets are sold or are put back to RTC because of defects or misrepresentations. These projections are in line with RTC estimates produced for its 1991 financial statements and with estimates recently reported by the former RTC President and Chief Executive Officer.

To eliminate funding shortages and costly delays, the Oversight Board is requesting a $28 billion appropriation for RTC--an amount equal to the high end of the Oversight Board's estimated cost range. Although currently identified failures may prove less expensive than estimated, it is likely that, between RTC and SAIF, at least $28 billion in additional appropriated loss funds will be needed before the thrift crisis is cleaned up.

Failed thrifts generally do not improve over time and their resolution cost remains an obligation that becomes more expensive when delayed. If RTC is not given sufficient funding, SAIF is likely to face a backlog of failed thrifts when it begins its resolution responsibility on October 1, 1993. With an expected fund balance of less than $1.5 billion on that date, SAIF would not be able to handle significant resolution costs without appropriated funds or direct Treasury borrowing.

Funding SAIF

Present law provides SAIF with two primary funding sources that may be used for resolution activity--insurance assessments and

Treasury payments. To the extent that insurance assessments paid into SAIF do not total $2 billion a year, Treasury is required to fund the difference from fiscal years 1993 through 2000 with appropriations for that purpose--the maximum Treasury funding available through this mechanism would be $16 billion. However, Treasury also is required to make annual payments, out of appropriated funds, as necessary to ensure that SAIF has a specified net worth, ranging from $1 billion in fiscal year 1993 to $8.8 billion during fiscal year 2000. The cumulative amounts of the net worth payments can provide SAIF with up to another $16 billion. Thus, a combined maximum of $32 billion can be provided through both mechanisms.

The Thrift Depositor Protection Oversight Board has estimated that SAIF will need up to $17 billion in appropriated funds to complete the resolution of thrifts expected to fail between 1994 and 1998. This estimate was based on an OTS caseload of 105 problem thrifts with $66 billion in assets that are considered possible resolution candidates after March 1994. The Oversight Board has requested that those funds be appropriated now for SAIF. Because of the uncertainties inherent in attempting to project thrift failures 2 to 5 years into the future, we cannot comment on the reasonableness of the Oversight Board's estimate.

However, as discussed above, the revenue sources for SAIF would, if employed, provide SAIF with up to $32 billion. These amounts should be sufficient to cover the Oversight Board's currently projected resolution costs and allow SAIF to gradually build up to the FIRREA-designated reserve ratio of 1.25 percent of industry insured deposits. Based on the total insured deposit base on September 30, 1992, SAIF would need a fund balance of $8.4 billion to meet the designated ratio. In addition, SAIF shares with the Bank Insurance Fund, the FDIC authority to borrow up to $30 billion under the Federal Deposit Insurance Corporation Improvement Act (FDICIA). Any borrowings on behalf of SAIF would require repayment by the thrift industry.

To cover the possibility that the entire appropriation may not be needed for the thrifts that actually fail during the period when RTC has resolution authority, we believe that the appropriation should provide for RTC to transfer to SAIF any appropriated funds RTC later determines it does not need. These funds would enable SAIF to carry out resolutions without costly delays.

Our high risk report documented many long-standing problems for which RTC needs to take aggressive action, some of which I will discuss shortly. Still, RTC should be provided the funds it needs to continue its resolution responsibilities. Without funding, the cost of the thrift clean-up only increases.

CAREFUL PLANNING NEEDED AS RESOLUTION AND DISPOSITION RESPONSIBILITIES MOVE TO FDIC

The transfer of resolution and disposition responsibilities from RTC to FDIC will require diligent planning and close coordination between the two organizations. For example, given the uncertain prospects for future bank and thrift failures, RTC and FDIC need to work together to ensure that FDIC has the institutional capacity to handle its added responsibilities. In this regard, we believe that the administration needs to provide Congress with detailed plans on how RTC and FDIC intend to accomplish the transfer and implementation of resolution responsibilities on September 30, 1993. In addition, a similar plan should be prepared to accomplish the transfer of asset management and disposition functions, which is scheduled to occur no later than December 31, 1996.

We disagree with the proposal by the former RTC President and Chief Executive Officer to consolidate RTC functions and staff with FDIC by the end of calendar year 1993. An accelerated phase-down of RTC would transfer responsibility for thrift asset disposition to FDIC before the thrift cleanup is completed. RTC's inventory at the end of calendar year 1993 could be sizable--between $40 and $60 billion--and contain many hard-to-sell assets. Disposing of these assets would require an intensive management effort. An early shutdown could be disruptive to current RTC operations and confuse responsibility and accountability for the thrift cleanups. Finally, it would prematurely burden FDIC with new responsibilities for disposing of assets from failed thrifts, which could strain FDIC's ability to carry out its present bank regulation, insurance, and asset disposition responsibilities.

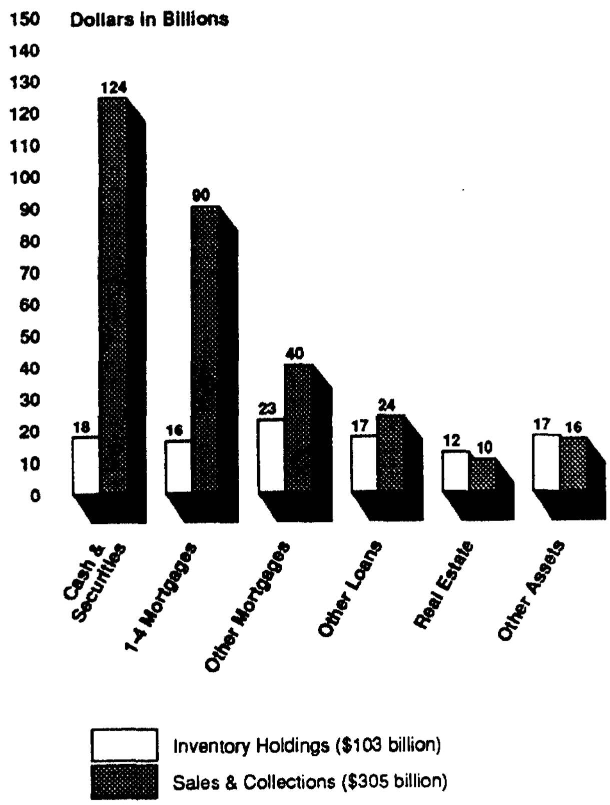
BILLIONS IN ASSETS SOLD, BUT MOST REMAINING INVENTORY IS HARD-TO-SELL

RTC had responsibility for the largest asset disposition effort ever undertaken in the United States. As of December 31, 1992, RTC had disposed of assets with a book value of about $330 billion, or about 75 percent of the assets that have come under its control.[2] RTC had sold financial assets with a book value of about $278 billion as of December 31, 1992, as shown in figure 1. By financial asset type, this includes almost $124 billion in cash and securities, about $90 billion in 1-4 family residential mortgages, almost $40 billion in other mortgages, and about $24 billion in other loans. RTC also had sold real estate assets valued at $10 billion, and other assets valued at $16 billion. Figure 1 also shows that RTC had a remaining inventory of all financial assets with a book value of $74 billion, real estate

[2]In this case, "book value" refers to the value at which an asset is carried on a thrift's balance sheet. It may differ considerably from other estimates of value, such as appraised value or market value.

assets valued at $12 billion, and other assets valued at $17 billion.

Figure 1: Inventory, Sales & Collection Totals (as of 12/31/92)



Overall, RTC has recovered, through sales and collections, a total of $305 billion, which is 92 percent of the book value of the assets sold.[3]

[3]Because some financial asset sales require certain RTC representations and warranties, which may allow purchasers to "put back" defective or misrepresented assets, RTC's final recoveries may be lower.

Although RTC has sold a large volume of assets, it still has an enormous and difficult job ahead. RTC's remaining inventory had a book value of approximately $103 billion as of December 31, 1992. About 75 percent of its remaining assets, by book value, are considered by RTC to be hard to sell. RTC defines hard-to-sell assets as all real estate owned; all loans except performing single family loans; and other assets, such as equity participations and investments in subsidiaries. Moreover, as I mentioned previously, RTC can expect to receive at least $30 billion in additional assets from thrift institutions that fail before the end of September 1993.

RTC GOALS STRESS INVENTORY REDUCTION, NOT MAXIMIZING RECOVERIES

Although FIRREA requires that RTC pursue a goal of maximizing recoveries on its asset sales, RTC's disposition efforts have primarily emphasized book value reduction. RTC's 1992 book value reduction goal was $100 billion, which it exceeded by $1 billion; for 1993, the goal is $70 billion.

RTC's program objectives generally emphasize reducing asset inventory rather than maximizing recoveries. For example, RTC established a goal of selling all real estate owned assets valued at $500,000 or below within 1 year of acquisition. In order to meet this goal, along with the RTC-wide book value reduction goal, RTC's Atlanta office held 76 auctions in the 6-month period from April 1 through September 30, 1992.

We looked at four auctions held in the Washington, D.C. and Baltimore, MD area, and found that the emphasis on reducing asset inventory led RTC staff to disregard established RTC policies and procedures. RTC failed to provide potential buyers complete and accurate asset information, allow adequate time to evaluate assets, and properly prepare assets for sale. These planning and management inadequacies caused delays in closing, cancellations of contracts, and lower recoveries.

Improvements Still Needed in Information Systems to Better Manage Assets

Since 1990, we have expressed concern about RTC's inability to develop adequate information systems to support its critical mission of managing and selling assets. For example, we reported in March 1992 that the Real Estate Owned Management System (REOMS) data contained property records that were incomplete and inconsistent.[4] About 80 percent of the unsold properties on REOMS lacked one or more key data elements, such as listing price, date listed for sale, and identification of broker. RTC is now implementing a data integrity program. However, as of

[4]Resolution Trust Corporation: Status of Real Estate Owned Management System (GAO/IMTEC-92-36BR, Mar. 5, 1992).

February 1993, RTC found that about 37 percent of its asset records in REOMS still contained one or more errors.

We also reported in October 1992 that the Asset Manager System (AMS) was experiencing a number of problems, including transferring asset income and expense data from contractors to RTC, calculating management and disposition fees for certain types of asset managers, and ensuring proper payments to contractors.[5] To address these problems, RTC agreed to fully test AMS to ensure that its modifications would meet user needs before they were implemented for RTC-wide use. RTC has tested and implemented system modifications and is working on strengthening the system's controls to ensure proper payments. However, because some of these controls have not been implemented and others have only been recently implemented, we cannot comment on their effectiveness.

RTC Lacks Data to Effectively Evaluate Sales Methods

RTC has used a variety of sales strategies to target assets to a wide range of investor markets to achieve its sales goals. But RTC has not effectively assessed its various sales methods

[5]Resolution Trust Corporation: Asset Management Systems (GAO/IMTEC-93-9R) Oct. 28, 1992.

because it does not routinely collect and analyze the necessary sales and financial data.

RTC attempted to analyze its sales strategies in December 1992, after it had already disposed of over $300 billion in assets. The analysis compared recoveries on hard-to-sell assets sold as of March 1992 through three alternative sales strategies: (1) private sector contractor sales under Standard Asset Management and Disposition Agreements (SAMDAs), (2) RTC portfolio or bulk asset sales, and (3) RTC auction sales.

The results suggested to RTC that gross returns from RTC portfolio sales and auctions were about the same as gross returns from SAMDA sales. RTC believes the analysis of net returns showed that portfolio and auction sales are generally as effective, and for selling loans more effective, than similar asset sales through SAMDA contractors. RTC further believes that the results support its emphasis on "wholesale" approaches for asset disposition.

However, we believe the results are inconclusive because of data limitations and caveats cited in the study. For example, the study noted that the data did not reflect all nonperforming loan sales because RTC used data from AMS, and these data were incomplete.

The study also noted that sales methods may have been misclassified. Assets originally assigned to SAMDAs may have been withdrawn and sold by RTC through other methods such as auctions or portfolio sales. Such sales may have been counted as SAMDA sales because neither REOMS nor AMS identified the sales methods. The study further acknowledged that important financial data were excluded from the analysis. Specifically, property management expenses, operating income and expenses, and litigation and foreclosure expenses were not available for assets sold through portfolio and auction sales.

Furthermore, RTC does not require its asset management contractors to prepare standard reports using sales and financial data. In our recent effort to review over 5,100 real estate and loan assets managed by RTC's SAMDA contractors, RTC could not provide critical data, such as revenues, expenses, sales prices, and contractor fees, for 64 percent of these assets. According to RTC officials, this information was not available because some field offices do not require reporting until assets are sold.

In another example, RTC does not collect consistent and comprehensive information about loan portfolio sales. Although RTC field offices and the National Sales Center prepare reports on loan portfolio sales results, the types and amounts of information shown in these reports vary greatly. Furthermore, because these reports are not summarized RTC-wide, overall results on loan portfolio sales are not available for analysis and evaluation. Without consistent and comprehensive sales information, RTC cannot measure the success of its loan portfolio sales effort or identify potential improvements in the loan portfolio sales process.

We also believe that RTC must improve its information and reporting system to maximize returns on its hard-to-sell assets. If information on holding costs, holding periods, revenues, net proceeds, and sales methods used were readily available, RTC could more effectively manage its disposition programs. With this information, RTC could better evaluate the effectiveness of various sales methods, target assets for specific programs, reduce holding costs and increase asset net recoveries. Data from RTC's disposition efforts also could be used to help design and direct the future asset management and disposition efforts of FDIC and other federal organizations.

Innovative Disposition Strategies Require Careful Evaluation and Oversight

RTC continues to develop and use innovative strategies to reduce its inventory of hard-to-sell assets. Careful assessment of these new strategies is important because of their untested nature.

For example, RTC has developed a new program to securitize non-performing loans and has estimated that it will dispose of up to $2.6 billion in assets through this program. RTC also initiated Multiple Investor Funds and the National Land Fund, in which it retains a partial ownership interest in the assets sold. RTC expects the Multiple Investor Fund program to dispose of up to $10 billion of nonperforming and subperforming commercial mortgage loans and real estate.

The Land Fund is expected to include land and land loans with a book value of up to $2 billion. Unfortunately, the development and implementation of the Land Fund has been hampered by a lack of current and accurate data. Because RTC lacked an information system to accurately report its real estate inventory, it hired a contractor to perform a field survey to collect information on the types, characteristics, and quantity of RTC land for the Land Fund.

While these initiatives could transfer up to $15 billion of assets to the private sector, it will take several years for RTC to realize its total recoveries. RTC must carefully analyze these programs to estimate their projected recoveries and determine their effectiveness as well as ensure that adequate safeguards and oversight mechanisms are in place to protect the taxpayers' interests.

Progress in Affordable Housing

One area in which RTC continues to make progress is in selling affordable housing to low- and moderate income families. As of January 31, 1993, RTC reported that it had closed sales on 13,999 single-family and 30,217 multifamily units. According to RTC, about 60 percent of affordable housing properties were in the very low-income and lower-income categories. We reported last year that RTC lacked adequate internal controls to ensure that prospective buyers met income eligibility requirements or complied with the single-family program's occupancy requirements.[6] RTC is taking actions intended to correct these weaknesses.

Similar to the single-family program, the multifamily program lacked RTC-wide procedures and systems for monitoring and oversight.[7] In response, RTC is taking several actions including (1) implementing procedures to detect noncompliance with eligibility requirements; (2) developing a post-purchase monitoring system to ensure properties are owner-occupied for at least 12 months; and (3) monitoring program violations, in particular those referred to RTC's Inspector General. We also

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[6] Resolution Trust Corporation: More Actions Needed to Improve Single-Family Affordable Housing Program. (GAO/GGD-92-136, Sept. 29, 1992).

[7] Resolution Trust Corporation: Affordable Multi-Family Housing Program Has Improved But More Can Be Done. (GAO/GGD-92-137, Sept. 29, 1992).

reported that the multifamily portion of the program was not conforming to the individual sales preference provisions of the law.

Building on the affordable housing program's success in selling properties, the National Housing Advisory Board, working with the major federal agencies and government-sponsored enterprises dealing in housing, established a 6-month pilot project in Dallas, TX to jointly market affordable housing properties through a clearinghouse. The pilot began in October 1992, and RTC joined with seven other organizations to market properties through the Federal Home Loan Bank of Dallas.[8] The Thrift Depositor Protection Oversight Board has established an evaluation program to assess the results of the effort. If successful, the pilot could serve as a model for more efficiently and effectively marketing the government's housing and other assets.

WEAK CONTRACTING RULES AND PROCEDURES CONTINUE TO PLAGUE RTC

In creating RTC, Congress provided it with the authority to establish its own procurement rules and procedures. As of

[8]The other organizations are the Farmers Home Administration, FDIC, the General Services Administration, the Department of Housing and Urban Development, the Department of Veterans Affairs, the Federal Home Loan Mortgage Corporation, and the Federal National Mortgage Association.

February 1993, RTC had over 25,000 active contracts with estimated fees of almost $2.4 billion. Although both we and the RTC Inspector General have found numerous instances of excessive costs paid to contractors, there is no way to estimate how much in total RTC may have lost through overpayments or undercollections due to weak controls and oversight of contractors. Although RTC has made some improvements to its contracting policies and procedures, it has had little success in ensuring that its staff adequately comply with them. RTC's failure to follow its own contracting procedures has resulted in millions of dollars of increased costs over the past 2 years. Because RTC has had repeated problems in awarding, managing, and monitoring contracts, we believe that RTC top management needs to take strong action to ensure that adequate controls on RTC's contracting activities are established and followed to prevent further abuses.

Changes Made to Contracting Procedures

Since our last performance assessment, RTC has made several changes to its contract selection and administration procedures such as revising its contracting manual and clarifying delegations of authority to issue contracts. RTC also created a contracting officer warranting program, which limited the authority for signing contracts and obligating RTC. This change was designed to reduce the likelihood that RTC staff unfamiliar with contracting system requirements would award contracts. But, as I will discuss in a moment, many of these changes have not been effective because contracting procedures were not uniformly followed.

In June 1992, RTC created three headquarters positions to help ensure that staff comply with RTC policies and procedures and coordinate contracting operations. In August 1992, RTC established a competition advocate program to help promote fair and adequate competition in the award of contracts. These were good steps, but RTC has assigned only 13 people to monitor the issuance of the thousands of contracts per year initiated by 6 RTC field offices and headquarters.

Moreover, RTC still lacks an information system for monitoring compliance with contracting policies and procedures. The RTC Contracting Activity Reporting System provides only an inventory of contract solicitations and awards. It does not provide information needed to monitor ongoing contracting operations, such as

-- the type of procurement and level of delegated expenditure approval,

-- the number and cost of contract amendments, and

-- payments made to contractors.

So, with limited staff and information, it is unlikely RTC will be able to ensure compliance with contracting policies and procedures.

Millions Wasted Because Contracting Procedures Were Not Followed

During the past year, RTC staff essentially disregarded their own contracting procedures for certain major, high-cost contracts. As we reported in March 1992, RTC's Western Region improperly issued a $24 million contract for its Western Storm Project to reconcile asset records for 92 failed thrifts.[9] When a headquarters official did not approve the use of noncompetitive contracting procedures, the region split the contract into 92 task orders and awarded all of them to one contractor without competition. Further, the contracts were issued without the approval of RTC's legal and contracting offices.

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[9]Resolution Trust Corporation: Preliminary Results of Western Storm Investigation and Related Contracting Deficiencies (GAO/T-OSI-92-5, Mar. 3, 1992) and (GAO/T-GGD-92-16, Mar. 3, 1992); Resolution Trust Corporation: Western Storm Follow-Up (GAO/GGD-93-8R, Dec. 4, 1992).

Contracting Problems at HomeFed

Although RTC management acknowledged that contracting weaknesses existed following the Western Storm project, similar problems were repeated at HomeFed Savings Bank in San Diego, CA. In addition to the recent contracting problems at HomeFed identified by RTC's Inspector General,[10] we identified instances of noncompliance with RTC contracting procedures, poor planning, administration, and oversight problems in the HomeFed contracts we reviewed.

-- On one of the due diligence contracts, RTC's National Sales Center officials were not authorized under RTC's contracting procedures to modify fees under the contract. Although some adjustment to the fees may have been warranted due to the volume and complexity of the work to be done, Sales Center officials did not involve the contracting officer and Legal Division in the modification of the fee schedule as required by RTC's contracting procedures. Also, Sales Center officials did not independently verify information submitted by the contractor to support the fee increase for the services provided. As a result, RTC had no assurance that these fees, which increased the contract from $161,000 to nearly $1.4 million, were reasonable.

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[10] RTC's HomeFed Contract With Price Waterhouse, RTC Inspector General, Testimony 93-1 (Feb. 19, 1993).

National Sales Center officials also did not involve the contracting officer and the Legal Division in expanding the scope of the work. Sales Center personnel asked the contractor to develop a special derived investment valuation methodology and negotiated a fee of nearly $900,000 for this work. While the work was subsequently completed, it was not covered by the original contract. Under RTC's contracting procedures, this was a new requirement and should have been issued as a separate contract.

-- HomeFed engaged a law firm to screen sensitive documents and to provide document control services. After RTC became the thrift's conservator, it continued the contract, but did not explore alternatives to using the existing firm. Also, RTC officials did not take adequate steps to assure that the fees under the contract were reasonable. They did not determine what the firm was paid by HomeFed prior to RTC conservatorship. Therefore, they were not aware that the firm increased the billing rates charged to RTC. For example, the partner's billing rate increased from $95 per hour to $150 per hour. Further, RTC's oversight official was not aware that RTC also paid for most of the firm's overhead expenses including supplies, phones, office space, photocopiers, and some temporary staff. RTC estimated the engagement would net the firm a possible annual profit of about $400,000 from the total estimated engagement costs of about $970,000 under the original engagement terms. After we brought this situation to RTC's attention, the scope of work under this engagement was substantially reduced because RTC determined that some of the engagement services would be obtained for less cost from other sources.

-- On the environmental assessment contracts, there were contract management and oversight problems. Only two RTC staff were assigned to manage and oversee the preparation of over 500 environmental assessments at HomeFed. This contributed to a situation where environmental assessment reports that should have been ordered were not, and some that were ordered were not needed or not completed.

RTC also ordered duplicate environmental assessment reports for some HomeFed assets. RTC did not determine whether these assessments had already been completed by HomeFed and did not coordinate the ordering of assessments from several environmental assessment consultants. These duplicate assessments resulted in additional costs of about $380,000.

Further, RTC either failed to order or failed to complete environmental assessments for assets valued at about $387 million. RTC's failure to produce completed reports allows the buyers the opportunity to withdraw from the sales without penalty. As a result, RTC is at risk of losing sales on assets in escrow.

Strong Top Level Commitment Needed to Strengthen Internal Controls

The basic problem, as we have repeatedly stated in testimonies and reports, is that RTC values the need to dispose of assets quickly more than complying with contracting internal control procedures designed to prevent fraud, waste, and abuse in contracting operations. The well publicized problems with the Western Storm project--followed just a few months later by problems at HomeFed--suggest that RTC staff continues to fail to appreciate the importance of sound contracting procedures.

RTC needs to take strong actions quickly to ensure that its staff comply with the contracting system. These actions include installing an information system to assist with monitoring staff compliance with contracting procedures and providing a more appropriate number of staff to monitor contracting operations. Further, RTC top management needs to strengthen its commitment to assure that employees follow established contracting procedures.

Contractor Oversight Needs Improvement

A large percentage of RTC's assets are serviced, managed, and sold by private sector contractors. RTC's asset sales and collections from its inception through December 31, 1992, totaled about $305 billion; much of this was managed or collected by thousands of private sector contractors. Contracted asset servicers are responsible for collecting and remitting to RTC billions of dollars in principal and interest payments and asset sales proceeds each year. However, without adequate oversight of asset servicers, RTC cannot be sure that servicers accurately account for and remit loan payments and sales proceeds.

In an April 1992 report, we stated that RTC did not adequately oversee its inherited loan servicers responsible for handling $7.5 billion of the mortgages and loans held by thrifts in receivership.[11] As a result, we found that RTC might not be recovering all it should from its receiverships. We also found, as part of our 1991 financial audit work, that RTC receiverships could not predict how much money they should be recovering from asset servicers. Based on these findings, we reported in our 1991 financial statement opinion that RTC's cash flow statement only reflected the cash it had actually received and not necessarily

[11]Resolution Trust Corporation: Oversight of Certain Loan Servicers Needs Improvement (GAO/GGD-92-76, Apr. 24, 1992).

what it should have received.[12] Lack of servicer oversight could result in higher resolution losses and higher costs to taxpayers.

For the 1992 financial audit, we have the same concerns about adequate RTC oversight and accurate RTC recoveries. As part of our year-end work, we are reviewing RTC's efforts to improve its oversight through its Inspector General's Office and its Office of Contract Oversight and Surveillance. The results of our review will affect our financial statement report due to the Congress in June of this year.

Although RTC currently is contracting for audits of some asset servicers, there may be a more efficient and less expensive way for RTC to cover all large servicers. RTC could require, as a condition of contract, that large servicers report on their internal controls and compliance with laws and regulations regarding activities under RTC contract. A case in point: Internal control breakdowns have contributed significantly to the failure of banks and thrifts, and in response to this problem, Congress has required large banks and thrifts to report on internal controls and compliance with law and regulations.

Specifically, FDICIA requires insured banks and thrifts with assets of $150 million or more to report annually on management's

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[12] Financial Audit: Resolution Trust Corporation's 1991 and 1990 Financial Statements (GAO/AFMD-92-74, June 30, 1992).

assessment of (1) the effectiveness of the institution's internal control structure and procedures and (2) the institution's compliance with applicable laws and regulations. This report must be signed by the institution's chief executive officer and the chief accounting or financial officer. In addition, FDICIA requires the institution's external auditor to report separately on management's assertions.

In applying the "banking model" described above, RTC could limit its application to its larger servicers. In addition, RTC could rely on the servicer's external auditor or RTC's own Inspector General or contract surveillance office to test the reliability of management assertions. Finally, RTC could specify which contract provisions must be considered in assessing compliance with laws and regulations.

FDICIA requirements are intended to focus management's attention on its accountability for internal controls and compliance with laws and regulations. Servicers with strong internal control structures are likely to record their receipts and disbursements accurately and to return to RTC all that is due. Control and compliance self-assessments, coupled with a program to independently and selectively test the assessments, could be an efficient and less costly way to improve RTC's oversight.

Minority- and Women-Owned

Business Participation Has Increased

RTC has made progress in having minority- and women-owned businesses participate in RTC's contracting activities. In 1992, minority-owned businesses received about $206 million, or 18 percent, and women-owned businesses about $116.5 million, or 10 percent, of the $1.1 billion in estimated fees paid by RTC. This combined 28 percent in fees to minority- or women-owned businesses is close to RTC's goal of awarding 30 percent of all contracting fees to such firms. Also in 1992, nine minority- and women-owned investment banks underwrote approximately $884.5 million in bonds as part of RTC's securitization program. This amount represented 4 percent of the total of $22 billion in securities issued in 1992.

RTC has made less progress in meeting goals for contracting for legal services. RTC paid about $274 million in legal fees for receivership matters in 1992 of which minority-owned law firms received almost $16 million, or 6 percent, and women-owned law firms about $9 million, or 3 percent. Although this represents almost a four-fold increase over the almost $7 million paid to these firms in 1991, it nonetheless is well short of RTC's goal of increasing fees paid to minority- and women-owned law firms to 20 percent.

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In summary, Mr. Chairman, we believe that RTC should be provided with the funds needed to resolve thrifts that already have failed and those likely to fail in the near future. Delay only serves to increase the final cost of resolving the thrift crisis. However, RTC must make progress in a number of key areas to ensure that taxpayers' costs are minimized. RTC needs to collect, assess, and fully use the basic business information that would allow it to better manage its inventory and ensure that its asset disposition strategies are maximizing recoveries. This is especially vital as RTC continues to use innovative approaches for disposing of assets, particularly for its large volume of hard-to-sell assets.

RTC also needs to correct long-standing weaknesses in its contracting system. RTC still does not appreciate the central role that a sound contracting system has in meeting its mission. The continuing problems at HomeFed are only the most recent cases of the poor contract planning, management, and oversight that have plagued RTC from the beginning. Contracting deficiencies have cost--and are continuing to cost--taxpayers millions of dollars.

This concludes my prepared statement, Mr. Chairman. My colleagues and I would be pleased to respond to any questions.

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