

**NATIONAL CREDIT UNION ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL**

**AUDIT OF NCUA'S ASSET MANAGEMENT  
ASSISTANCE CENTER**

**Report #OIG-12-06**

**March 19, 2012**



*William A. DeSarno*

**William A. DeSarno  
Inspector General**

**Released by:**

*James W. Hagen*

**James W. Hagen  
Deputy Inspector General**

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## **EXECUTIVE SUMMARY**

The Office of Inspector General (OIG) for the National Credit Union Administration (NCUA) engaged Crowe Horwath LLP (Crowe), to independently conduct a performance audit on its Asset Management Assistance Center (AMAC) to determine the efficiency and effectiveness of:

1. Policies/procedures and internal controls for the following areas:
  - asset recovery,
  - liquidations of member services, and
  - accounting services;
2. Payments of share accounts including closing out the account or return checks that occur; and
3. Valuation process and disposal of property and assets.

We performed our audit in accordance with audit standards contained in *Government Auditing Standards* (GAS), issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Because of inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk that some material misstatements or material non-compliance may not be detected exists, even though the audit is properly planned and performed in accordance with applicable standards. An audit is not designed to detect error or fraud that is immaterial to the performance audit objectives.

We conducted the audit through a series of interviews, documentation reviews, and detailed testing on a sample basis. We evaluated AMAC's controls and processes against standards and requirements for federal government agencies such as those provided through The Committee of Sponsoring Organizations of the Treadway Commission's (COSO) internal control framework and the Office of Management and Budget (OMB) Circular A-123 - Management's Responsibility for Internal Control.

### **Results in Brief**

Our audit focused on the internal controls over the Asset Recovery, Liquidations of Member Services, and Accounting Services divisions within AMAC including payments of share accounts, closing out the account or returns checks that occur; and the valuation process and disposal of property and assets. One of the main areas of focus of our audit was related to the liquidations of Norlarco Credit Union (Norlarco) and Huron River Area Credit Union (Huron). Considering this was a major focus of our audit due to the size and complexity of these liquidations, we included a section in this report

analyzing the results of these liquidations. Based on our analysis, we found deficiencies over the valuation process of real estate owned (REO) by AMAC. Specifically, AMAC did not perform valuations on these properties in accordance with industry standards and did not always maintain proper support for the valuations that were completed. In addition, we determined AMAC did not formally complete a cost to carry analysis on REO. We believe AMAC should have completed this type of analysis as part of its determination regarding whether to sell or hold real estate.

The results of our tests indicated that, except for the findings identified in this report, in all significant respects, AMAC's (1) Policies/procedures and internal controls for the following areas: (a) asset recovery, (b) liquidations of member services, and (c) accounting services; (2) Payments of share accounts including closing out the account or return checks that occur; and (3) Valuation process and disposal of property and assets; were operating as intended by AMAC management. However, we determined material weaknesses exist related to reo activities. The following provides a summary listing of the findings identified during our audit. These findings are included in detail in the **Results in Detail** section of this report.

Asset Recovery (AR):

- 01 REO Valuation Support
- 02 REO Valuation Documentation
- 03 REO Cost to Carry Evaluations
- 04 Reconciliations For Accounts with Attorneys
- 05 Approvals For Disposed Assets
- 06 Review of Servicer Auditor Report For Loan Provider

Accounting Services (AS):

- 01 Segregation Of Duties of Cash Disbursements
- 02 Liquidating Credit Union Reconciliations
- 03 Timeliness And Documentation to Support Account Reconciliations
- 04 Reconciliation Of Loans Between NCUA and Gila (Third Party Loan Service Provider)

Liquidation Services (LS):

- 01 Liquidation Checklist Completion and Review
- 02 Written Liquidation Procedures

We appreciate the effort, assistance, and cooperation management and staff provided to us during this review.

## **PROJECT OVERVIEW**

### AMAC Background

AMAC conducts credit union liquidations and performs management and recovery of assets. Additionally, this office assists NCUA regional offices with the review of large complex loan portfolios and actual or potential bond claims. Staff also participates extensively in the operational phases of conservatorships and records reconstruction.

### Objectives

Our objectives were to perform an independent audit to determine the efficiency and effectiveness of AMAC's:

- 1) Policies/procedures and internal controls for the following areas: (a) asset recovery, (b) liquidations of member services, and (c) accounting services;
- 2) Payments of share accounts including closing out the account or return checks that occur; and
- 3) Valuation process and disposal of property and assets.

### Scope and Methodology

We conducted this audit in accordance with performance audit standards contained in *Government Auditing Standards (GAS)*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Because of inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements or material non-compliance may not be detected, even though the audit is properly planned and performed in accordance with applicable standards. An audit is not designed to detect error or fraud that is immaterial to the performance audit objectives.

In making our risk assessments, we considered those internal controls that were significant within the context of the audit objectives in order to design audit procedures that were appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of AMAC's internal control environment. However, this report communicates in writing to those charged with governance and management concerning any significant deficiencies or material weaknesses in internal control significant within the context of the audit objectives that we have identified during the audit.

We have also obtained an understanding of internal control that is significant within the context of the audit objectives. For internal control that is significant within the context of the audit objectives, we have assessed whether internal control has been properly designed and implemented. For those internal controls we deemed significant within the context of the audit objectives, we performed tests of controls including testing underlying transactions, as required by GAS standards, to evaluate the effectiveness of the design and operation of controls. This report includes any deficiencies or other matters involving internal control as required by GAS standards.

Our audit and work product are intended for the benefit and use of the NCUA only. The audit was not planned or conducted in contemplation of reliance by any other party or with respect to any specific transaction and is not intended to benefit or influence any other party. Therefore, items of possible interest to a third party may not be specifically addressed or matters may exist that could be assessed differently by a third party.

We conducted an audit of AMAC's internal controls over asset recovery, liquidations of member services, and accounting services - including payments of share accounts. This included testing the closing out of shared accounts and testing returned checks. This also included an analysis of the valuation process and disposal of property and assets as described below.

We conducted our fieldwork from June 2011 through February 2012. We performed our audit in accordance with generally accepted government auditing standards (GAGAS) and audit standards promulgated by the American Institute of Certified Public Accountants (AICPA). In order to conduct this audit, the engagement team performed the following tasks:

- Held an entrance conference on-site at AMAC on June 20, 2011 to discuss the scope of the audit, identify key contact personnel, and to outline the planned schedule.
- Asset Recovery
  - ◆ Obtained Policies and Procedures over Loan Management.
    - Reviewed Policies and Procedures and created a high level process flow including loan acquisition, loan valuation, loan processing (including payments and modifications), and loan sales. We also reviewed the following processes: Lockbox, Loan Servicing (Gila, other contracts, in-house), Loan Collections, Collections (i.e. auction sales), Loan Modifications, and Foreclosures.
    - Documented significant controls over each process.

- Interviewed Management (and performed walk-throughs of process where possible) to determine actual process performed for Loan Management processes.
  - Determined whether differences exist between documented policy/procedure and procedure described during interview/walkthrough.
  - Assessed the current processes and controls for loan management and determined any inefficiency in the process (e.g. duplicative procedures, untimely procedures, unnecessary steps, etc...) and any control deficiencies/gaps.
  - Performed tests of effectiveness of key control(s).
- ◆ Obtained Policies and Procedures Over Real Estate (RE) Management
    - Reviewed Policies and Procedures and created a high level process flow including RE acquisition, RE valuation, RE maintenance, and RE sales. Also reviewed the following processes: monitoring of properties, valuation of properties, bulk sales, rental properties (payment collections, credit worthiness of renters, evictions, carrying costs), and remediation of drywall issue.
    - Documented significant controls over each process.
    - Interviewed management (performed walk-throughs of process where possible) and documented actual process performed for RE Management processes.
    - Determined whether differences exist between documented policy/procedure and procedure described during interview/walkthrough.
    - Assessed current processes and controls for the RE process and determined any inefficiencies in the process (e.g. duplicative procedures, untimely procedures, unnecessary steps, etc...) and any control deficiencies/gaps.
    - Performed tests of the key control(s).
- ◆ Obtained Policies and Procedures for Other Assets obtained by the Division of Asset Recovery (DAR)
    - Determined that the policy covers key areas, was up to date and was reviewed within the past year.
- ◆ Determined whether AMAC performed timely, independent, and supported reviews over reconciliations.
    - Through inquiry with management, documented the process involved for performing account reconciliations.
    - Obtained and reviewed the Q4 2010 and Q1 2011 "Asset Acquired Reconciliations," "Accounts with Attorneys Reconciliations," and the

January through May 2011 "Acquired Credit Unions Reconciliations."

- Liquidations of Member Services
  - ◆ Obtained Policies and Procedures Over Liquidations:
    - Reviewed the Policies and Procedures and created a high level process flow including on-site procedures, securing of assets, selling of other assets (e.g. FF&E), handling liabilities, and purchase and acquisitions.
    - Documented significant controls over each process.
    - Interviewed management (performed walk-throughs of process where possible) to determine actual process performed for the Liquidation processes.
    - Determined whether differences exist between documented policy/procedure and procedure described during interview/walkthrough.
    - Assessed current processes and controls for liquidations and determined any inefficiency in the process (e.g. duplicative procedures, untimely procedures, unnecessary steps, etc...) and any control deficiencies/gaps.
    - Performed tests of effectiveness of key control(s).
  - ◆ Determined whether liquidated credit unions were approved and were liquidated in a timely manner.
  
- Accounting Services
  - ◆ Obtained policies and procedures relating to Accounting Services and:
    - Reviewed the Policies and Procedures and created a high level process flow including on-site procedures, securing of assets, selling of other assets (e.g. FF&E), handling liabilities, purchases and acquisitions (P&A's), and valuation allowances for assets.
    - Documented significant controls over each process.
    - Interviewed management (performed walk-throughs of process where possible) and determined actual process performed for the Liquidation processes.
    - Analyzed whether differences existed between documented policy/procedure and procedure described during interview/walkthrough.
    - Assessed current processes and controls over accounting services and identified any inefficiencies in the process (e.g. duplicative procedures, untimely procedures, unnecessary steps, etc...) and any control deficiencies/gaps.
    - Performed tests of key control(s).



- ◆ Determined whether general ledger (g/l) account reconciliations are performed timely and contain independent review.
- ◆ Determined whether journal entries are prepared and independently approved according to policy.
- ◆ Determined whether appropriate segregation of duties exists:
  - Through inquiry with management, determined who was responsible for authorizing check disbursements, maintaining check custody, and signing check disbursements (the disbursement process).
  - Through inquiry with management, determined whether the returned check process functions as intended.
- Payments of share accounts
  - ◆ Determined whether checks are properly disbursed for closed accounts.
  - ◆ Determined whether shared accounts suspected of fraudulent activity are not paid.
  - ◆ On a sample basis, tested whether share payments are made to fictitious members of liquidated credit unions.
  - ◆ Determined whether Credit Union system information is accurately input into AMAC's system
- Valuation and Disposal Process
  - ◆ Determined whether management properly values and disposes of loans obtained from liquidated credit unions.
  - ◆ Obtained a listing of loans sold from liquidated credit unions and on a sample basis tested for the following:
    - Determined whether management properly valued and recorded accurately REO and Repossessed Assets.
  - ◆ Reviewed management's analysis of properties obtained from Norlarco and Huron River Credit Unions and on a sample basis determined:
    - Whether the analysis was approved for maintaining the properties individually versus selling them in a bulk sale.
    - Whether the cost benefit analysis used at the time of the decision was effective and if this analysis was performed on an on-going basis to determine the right mix of maintaining vs. selling the properties.
  - ◆ Determined whether any other assets were properly recorded.
    - Obtained a listing of assets held from liquidated credit unions. Scanned the listing for significant assets that have not been tested and ensured they were properly recorded.
- Held an exit conference on January 26, 2012, to discuss observations noted.

## **Overall Conclusions**

The results of our review indicated that, except for the findings identified in this report, in all significant respects, AMAC's (1) Policies/procedures and internal controls for the following areas: (a) asset recovery, (b) liquidations of member services, and (c) accounting services; (2) Payments of share accounts including closing out the account or return checks that occur; and (3) Valuation process and disposal of property and assets; were operating as intended by AMAC management.

## RESULTS IN DETAIL

We divided our report into three sub-sections – Asset Recovery, Accounting Services, and Liquidation Services. Each subsection includes an introduction and a discussion of our audit procedures and includes findings and recommendation(s) for that area, as well as our overall conclusions based on the audit objectives.

### Asset Recovery

AMAC's Division of Asset Recovery is responsible for maintaining and liquidating assets assumed from credit unions. This includes, but is not limited to, loans to members, furniture, equipment, properties, etc. DAR utilizes a third party loan servicer for maintaining member loans. As AMAC assumes assets such as loans, furniture, and properties, DAR works to liquidate the assets to offset expenses related to the credit union. This includes the entire process from obtaining the assets, valuating the assets, and finding potential buyers. In addition, DAR utilizes attorneys for collection purposes and any pending legal issues such as foreclosures for assets assumed through the liquidations.

We performed procedures over Asset Recovery including obtaining and reviewing written policies and procedures over loan management, real estate management and other assets. We also performed walkthroughs of the loan, real estate, and other asset processes. During these walkthroughs, we observed the actual procedures and compared our results to AMAC's written policies and procedures and noted any differences or deficiencies. Based on these procedures, we noted that AMAC management has procedures and controls in place over loan, real estate and other asset management, but does not currently have strong procedures for valuing real estate (see below for further discussion), reconciling accounts with attorneys (Finding AR-05), or reviewing SAS 70 reports (Finding AR-08).

We also performed testing over the valuation and disposal of asset process. This testing consisted of selecting a sample of loans sold from liquidated credit unions to determine whether AMAC properly valued and accurately recorded REO and Repossessed Assets. In addition, we performed testing to determine whether AMAC's analysis regarding whether to maintain the properties individually versus selling them in a bulk sale had been approved, and if the cost benefit analysis used at the time of the decision was effective. We also performed testing to determine whether AMAC performed an analysis to determine the right mix of maintaining vs. selling the properties on an on-going basis.

We determined that management's analysis regarding whether to maintain or sell the properties located in Florida that were assumed with the liquidations of Norlarco and Huron River Credit Unions, does not appear to be sufficiently comprehensive to support management's decision to hold the properties (Findings AR-01 through AR-04). During these procedures, we also determined that one disposed asset in our sample lacked the

proper approvals (Finding AR-06) and that other assets assumed during a liquidation were improperly recorded (Finding AR-07).

### **Norlarco and Huron River Analysis**

A major area of focus for this performance audit was over REO by AMAC. The largest amount of REO resulted from the liquidation of two credit unions – Norlarco Federal Credit Union (Norlarco) and Huron River Area Credit Union (Huron River) in 2008 and 2009 respectively. Therefore, this section includes an expanded write-up on these properties and includes additional analysis of activity related to these properties from liquidation through the date of this report. Overall, we determined AMAC management's analysis of whether to maintain or sell the properties located in Florida, that were assumed with the liquidation of Norlarco and Huron River, did not appear to be sufficiently comprehensive to support its decision to hold the properties.

As previously noted, NCUA liquidated Huron River and Norlarco in 2008 and 2009 respectively, which led to the assumption of approximately 1,741 properties located in southwestern Florida. Both credit unions were involved in financing residential real estate construction projects in this area creating both concentration risk and additional risk from inadequate oversight and control of the construction financing. This concentration and inadequate control was determined to be significant factors in the NCUA placing each credit union into receivership.

In our analysis of the properties related to Norlarco and Huron River, we found these properties carried a member value (outstanding loan amount) of \$194.8 million and a write down of that amount to a net book value of \$93.2 million, resulting in a recovery of 47.8 percent. We also determined that AMAC management estimated they could manage the loans at a cost of 59 percent of members' value versus selling the loans at only 32 percent of members' value. However, when factoring in known expenses to carry the properties of \$27.3 million from the net book value of \$93.2 million, the estimated cost to manage the loans is reduced to 33.8 percent. This 33.8 percent, however, does not take into account vandalism, theft, and outside contractor expenses, which would further reduce this recovery percentage.

As a result of the receivership of each of these credit unions, and ultimate liquidations and eventual assumption of properties, AMAC needed to determine a liquidation strategy which would maximize the value obtained for the properties acquired. Upon receipt of the properties, we learned that 861 properties were almost immediately used to satisfy portions of loans that were participated in by other banks. By allowing another bank or credit union to take possession of the properties, AMAC removed their interest in the property and satisfied their portion of the obligation for those loans that were assumed by AMAC. Per discussion with the Real Estate Analyst for AMAC, the participating banks had an approximate 90 percent interest in these loans. After satisfying the participating loans, AMAC was left with 880 properties, of which nearly 30 went through short sale and foreclosure auctions and were disposed of prior to AMAC obtaining the rights to the properties.

Based on documentation reviewed, an estimated 850 properties remained with AMAC that had a member value of approximately \$194.8 million and carried a Net Book Value at acquisition of \$93.2 million (the amount that was recorded on the books). The net book value was determined based on the lesser of cost (the member loan balance at time of repossession) or net realizable value at time of assumption (market value less anticipated costs to dispose), which was assumed to be 10 percent of market value.

Valuation of properties was determined by using a Broker Price Opinion (BPO)<sup>1</sup> for a sample of the properties located in the housing developments (of the 30 properties we tested, 22 did not have documentation to support the valuation). Once AMAC believed they had obtained sufficient knowledge on the value of the homes, they then estimated the remaining home values based on previously received BPOs due to the similarities between the properties.

AMAC identified a strategy they believed would maximize the value received for disposition of the properties. In December 2007, AMAC proposed selling 100 properties related to Huron River Area Credit Union in a bulk sale. Information related to this proposed bulk loan sale follows:

- The 100 loans carried a value of \$25.5 million in which AMAC's analysis concluded they could manage the loans along with their properties and collect 59 percent of the member's value by liquidating the properties themselves.
- AMAC utilized a third party broker in order to gauge interest in the sale of these loans. The third party broker notified AMAC that out of 184 potential bidders that reviewed the offering information, 11 had submitted a final bid. The final bids ranged from 8.28 percent to 32 percent of the member's value (member loan balance at time of liquidation).
- According to a December 17, 2007 memo from the President of AMAC to the Office of Examination and Insurance, AMAC believed that "continued AMAC management of these properties will result in a higher overall return to the NCUSIF."
- Per AMAC management, AMAC also factored in how the bulk loan sale could potentially impact local credit unions with loans to borrowers and REO properties within the same geographic market and to the remaining value of the properties held by AMAC (though no quantitative analysis was provided).
- AMAC management concluded the bulk loan sale would significantly increase the supply of properties for sale within the market and drive the prices on their remaining homes further down.

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<sup>1</sup> Broker Price Opinion is an estimated value of a property as determined by a real estate broker and is based on the characteristics of the property being considered.

- AMAC management determined that a bulk sale would lower housing prices within the market and ultimately devalue AMAC's portfolio of remaining homes.
- AMAC management further indicated that a bulk sale could negatively impact the collection efforts of local market credit unions with residential real estate loans and foreclosed properties within the same market.

Due to these factors, AMAC rejected the high bid of 32 percent for the portfolio of 100 properties.

To date, AMAC has sold 409 of the approximately 850 properties originally taken over as a result of the liquidation of Norlarco and Huron. The sales history is as follows:

CALENDAR YEAR	# OF PROPERTIES SOLD	SALES (IN DOLLARS)	AVERAGE SALES PRICE	MEMBER VALUE (LOAN BALANCE)	PERCENT OF MEMBER VALUE (LOAN BALANCE)
2007	0	\$0	\$0	\$0	0.00%
2008	16	2,788,929	174,308	4,099,848	68.03%
2009	174	18,601,345	106,904	41,614,556	44.70%
2010	163	15,045,648	92,305	37,125,489	40.53%
2011*	56	4,609,780	82,318	12,919,794	35.68%
<b>TOTALS</b>	409**	\$41,045,702	\$100,356	\$95,759,687	42.86%

\*Through June 30, 2011.

\*\*Table does not include 4 properties that were obtained as REO.

The table above reflects the decline of the average sales price and the percent of member value of the property held. This would appear to indicate that holding property is losing value.

As of June 30, 2011, AMAC has sold 409 properties for a total of \$41.0 million. These properties had an estimated member value of \$95.8 million, which resulted in AMAC realizing 42.8 percent of the member's value based on sales figures alone, but does not factor in expenses incurred for the properties sold.

In addition, AMAC has received rental income and incurred maintenance and selling costs during this period from 2007 through 2011. Based on information received, the following tables indicate total rental income and expenses since 2007:

<b>YEAR</b>	<b>RENTAL INCOME (IN DOLLARS)*</b>
<b>2007</b>	-
<b>2008</b>	\$22,644
<b>2009</b>	\$1,027,435
<b>2010</b>	\$1,485,478
<b>2011**</b>	\$794,149
<b>TOTAL</b>	\$3,329,706

\*\* Through June 30, 2011

<b>YEAR</b>	<b>TOTAL MAINTENANCE AND SELLING EXPENSES</b>
<b>2007</b>	(\$520,000)
<b>2008</b>	(\$10,386,972)
<b>2009</b>	(\$8,130,728)
<b>2010</b>	(\$6,520,140)
<b>2011**</b>	(\$1,830,885)
<b>TOTAL</b>	(\$27,388,725)

\* Summary information provided by AMAC. Detailed support has not been made available.

\*\* Through June 30, 2011

In addition, AMAC received \$8.3 million from a settlement related to these properties from the liquidation of Norlarco and Huron River Credit Unions.

All remaining properties have seen further decline in value and experienced a large amount of vandalism and theft. This can be determined by comparing the average sales value in 2011 of \$82,318 to all prior year average sales figures.

As a result, AMAC has hired an outside contractor responsible for inspecting the homes on a rotational basis to identify any repairs and maintenance that needs to be performed. In addition, AMAC also contracted with a property management company to manage the properties held and rented out. The property management company collects one half of the first month's rent as their commission and works with the tenants to collect rent and maintain the properties that are rented out. Currently, AMAC is renting out approximately 220 of the 437 remaining properties. The properties are rented out for an average of \$800 per month per property, which generates \$176,000 in revenue per month, or slightly over \$2.1 million per year.

AMAC maintains the properties not yet sold for around \$9,000 annually, per property, which includes the costs to make repairs as well as the real estate taxes. This estimate is based on a sample of 30 properties for which support for maintenance expenses were obtained. AMAC currently expects to sell the

remaining 437 properties over the next 2-3 years. Using a 3-year time frame to sell the remaining properties, at an average sale amount of \$82,000 (average sale price in 2011), we estimate AMAC will sell the remaining properties for \$35.8 million. Since AMAC's average holding time is one and a half years (based on consistent sales over three years divided by 2), we believe they would incur additional expenses of \$5.9 million (at \$9,000 per year per property multiplied by 1.5 years).

Therefore, based on the above figures and expected sales of \$35.8 million (less selling expenses of \$2.8 million, or 7.7 percent of sales price based on 2011 sales), and maintenance expenses of \$5.9 million, we believe AMAC could reasonably expect to realize approximately \$27.1 million on the remaining 437 properties. With a remaining member value of \$99.1 million, this amounts to a 27.3 percent realization on the remaining properties if sale and expense trends remained constant. In addition, if AMAC were to rent out one half of the properties until liquidation is complete, we estimate an additional rental income of \$3.2 million (220 properties multiplied by \$800 average monthly rental income multiplied by 18 month average holding period). This results in an adjusted realized amount of \$30.5 million, or 31 percent realization on the remaining properties.

As of June 30, 2011, we determined that sales from properties already sold totaled \$41.0 million, properties yet to be sold were estimated to be \$35.8 million, past rental income is \$3.3 million, and future rental income is estimated to be \$3.2 million. In addition to the \$8.3 million settlement; we determined AMAC can expect to gross \$92 million from sales, rental income, and legal settlements related to the properties located in Florida.

Total expenses related to these same properties includes \$27.4 million already incurred, \$2.8 million in estimated future selling expenses and \$5.9 million in estimated future maintenance expenses for a total of \$36.1 million.

Therefore, the net realized amount on Norlarco and Huron River properties obtained is estimated at \$55.9 million, or a 28.7 percent net realization on all properties obtained through liquidation of Norlarco and Huron River credit Unions. This net realization does not factor in time spent by internal AMAC resources over the years related to these properties.

Based on activity to date and expected sales going forward, it appears that the original return attainable by AMAC of 32 percent for the 100 properties that were considered for bulk sale in 2007 exceeds the June 30, 2011 expected net realized return of 28.7 percent.



## **Asset Recovery Findings**

### **AR-01 REO Valuation Support**

#### **Condition**

Based on the results of testing 30 properties held as REO and Repossessed Assets, we determined AMAC management did not document the evaluation for 22 (73 percent) of the properties at the time they were set up as REO. In addition, we noted that management does not have a documented review process for appraisals over \$250,000. Per inquiry with management, AMAC stated that for non-Florida properties, a BPO or appraisal for each property to support its NRV is obtained. AMAC also stated that market information when the property is listed for sale is obtained and before a property is listed for sale, approval is obtained from the AMAC official with delegated authority. As part of this approval process, information such as the BPO, appraisal, and other market information will be reviewed.

#### **Criteria**

When properties are transferred to REO, an appraisal or another form of valuation should be obtained and documented to support the value being transferred to REO. Appraisals for properties in excess of \$250,000 should be reviewed and have the review documented on an appraisal review form to support the review.

#### **Cause**

Division of Asset Recovery assumed a large number of properties in Florida from the liquidation of Norlarco and Huron River Area Credit Unions. As a result, AMAC obtained a large number of BPOs for similar properties in the same area in Florida. Based on these BPOs, DAR estimated the values of some properties without obtaining new BPOs due to nearly identical properties that were obtained. However, we found no documentation was maintained to show support as to what property was used or how the value was determined for the properties identified in testing. AMAC management also does not currently have a process in place to document review of appraisals greater than \$250,000. Furthermore, AMAC believes that the cost of obtaining individual appraisals or BPOs for each REO property at the time of conversion to REO outweighs the benefit of the information contained within the appraisals or BPO. BPOs are currently ordered and reviewed prior to properties being listed for sale in order to update values as necessary. For appraisals of a significant value, AMAC has a documented review process in place.

#### **Effect**

Due to the fragile housing market, borrowers who receive a cancellation of debt as a result of AMAC repossessing the asset affects the value of the property on AMAC's records as well as the balance sheet because amounts reported for cancellation of debt may be misstated without proper supporting documentation for the valuation of the properties and review of the appraisals used to validate the anticipated value.

### **Recommendations**

We recommend AMAC management:

1. Obtain appraisals or document valuation of all properties transferred into Real Estate Owned to support the fair value being transferred to REO.
2. Review and document all appraisals in excess of \$250,000 to ensure that the appraiser is independent and to verify that the support for the valuation is adequate.

### **Management Response**

Management agrees to capture more detailed documentation on the value of each property transferred to REO. Management indicated they currently obtain a Broker Price Opinion or appraisal for each property, or a Broker Price Opinion for homogeneous properties. Management also agrees to formalize the review of appraisals in excess of \$250,000.

### **OIG Response**

We concur with management's planned actions

## **AR-02 Valuation Documentation**

### **Condition**

Management's analysis of whether to maintain or sell the properties located in Florida and assumed with the liquidation of Norlarco and Huron River Credit Unions does not appear to be sufficiently comprehensive to support management's decision to hold the properties. Specifically, documentation to support the analysis was not available during our site visit to support the valuation determined by AMAC on the Norlarco and Huron River properties

### **Criteria**

Management should document their analysis used to support their decision to maintain properties versus selling them in a bulk sale.

### **Cause**

Management's analysis did not appear sufficiently comprehensive to support whether or not to sell or maintain the properties located in Florida.

### **Effect**

Management may not have adequate information or analysis in order to make the best decision if analysis is not sufficiently supported which may lead to financial loss.

### **Recommendation**

We recommend AMAC management:

3. Perform and document their analysis when determining whether to maintain properties versus selling them in a bulk sale, this would also include documenting potential financial outcomes for both options to support their decision making.

### **Management Response**

Management agrees to more clearly document their decisions when determining whether to maintain properties versus selling them in a bulk sale.

### **OIG Response**

We concur with management's planned action.

### **AR-03 REO Cost to Carry Evaluation**

#### **Condition**

AMAC management does not complete a formal or comprehensive analysis of the cost to carry REO property. Such an evaluation would allow management to analyze the financial position of properties to assist in its determination of the best fiscal course of action. In addition, this analysis could identify any properties that are outliers (have higher costs than normal) which might suggest a different course of action is required.

#### **Criteria**

Credit Union industry standards dictate that evaluations of REO should be performed on a periodic basis to determine the financial impact of holding the property as oppose to selling the property or vice versa.

#### **Effect**

Not performing a formal financial analysis of REO property could result in management making a decision related to REO that is not in the best financial interest of AMAC.

#### **Cause**

AMAC management has relied on information assessments of groups of properties to determine whether to hold or sell a property or group of properties.

#### **Recommendation**

We recommend AMAC management:

4. Formalize the cost to carry evaluation process for Real Estate Owned so that at any given point in time, management can analyze and compare market prices of a property to the cost to carry that property and determine whether to sell or hold the property.

#### **Management Response**

Management agrees to enhance the documentation and formalize the cost to carry analysis performed at a macro level.

#### **OIG Response**

We concur with management's planned action, so long as the cost to carry is applied to each individual property.

## **AR-04 Accounts with Attorneys**

### **Condition**

AMAC management does not oversee the performance of reconciliation for accounts with attorneys. From time to time, AMAC either directly or through external collectors, will have accounts placed with attorneys for collection. AMAC will normally contract with attorneys for collection work on a fee basis for hours worked.

### **Criteria**

Depending upon the particular legal services agreement (LSA), attorneys are required to submit periodic quarterly collection accountings of their contingency fee files, and annual collection accountings of their hourly fee files (some current LSAs may not have this requirement – all LSAs signed after June, 2006 should contain this provision). DAR is responsible for comparing those reports to the AFTECH balances and collection histories (DAS can provide a report of attorney accounts, by each attorney). Documentation supporting the comparisons are forwarded to and retained by DAS, along with any suggested correcting entries. The DAS director determines the proper accounting entry for the correction.

### **Cause**

No reconciliation is performed.

### **Effect**

Not performing reconciliations for accounts with attorneys could result in misstatements in loan balances not being identified by management.

### **Recommendation**

We recommend AMAC management:

5. Complete reconciliations for accounts with attorneys on a periodic basis, but at a minimum on a quarterly basis.

### **Management Response**

Management agrees to periodically complete reconciliations for accounts with attorneys.

### **OIG Response**

We concur with management's planned action.

## **AR-05 Approvals for Disposed Assets**

### **Condition**

Approval for the disposition of REO was not documented for two properties (asset number 248200029 and asset number 248200116)

### **Criteria**

Approval for the Disposition of REO should be documented by an authorized individual.

### **Cause**

AMAC management delegated authority for the sale of the first property, however delegation was not documented to support that proper approval was obtained. Management discussed the approval for the disposition of the second property though it was also not documented to support that authorized approval was obtained.

### **Effect**

The unauthorized disposition of REO may occur if proper approval is not obtained and documented to support the approval.

### **Recommendation**

We recommend AMAC management:

6. Document the delegation of authority along with the actual approval for the disposition of all REO assets.

### **Management Response**

Management agrees to continue to monitor and ensure approvals are fully documented and maintained.

### **OIG Response**

We concur with management's planned actions.

## **AR-06 Review of Servicer Auditor Report for Loan Provider**

### **Condition**

There is no formal review of the Servicer Auditor Report [Statement of Auditing Standards (SAS) 70 report or a SSAE 16 report which replaces SAS 70 during 2011] for Gila, LLC (Gila) and no documented support for the users controls implemented. Gila is a third party service provider for NCUA and handles the organization's loans maintenance and collections activities.

### **Criteria**

An annual review of the Servicer Auditor Report should be performed for major service providers to ensure accuracy of the information. User controls should also be documented to ensure proper controls exist for accuracy of the information.

### **Cause**

No SAS 70 review performed.

### **Effect**

Not performing a review of Servicer Auditor Reports could result in material control weaknesses of that service provider not being recognized and analyzed by AMAC management and could result in necessary user controls not being identified and implemented by AMAC.

### **Recommendation**

We recommend AMAC management:

7. Perform and document a review of Servicer Auditor Reports to ensure any material control weaknesses of that service provider are acknowledged and analyzed and to ensure that user controls are identified and in-place at AMAC.

### **Management Response**

Management agrees to review Servicer Auditor Reports noting that a report had been completed and the review documented.

### **OIG Response**

We concur with management's actions taken and planned.

## Accounting Services

AMAC's Division of Accounting Services (DAS) is responsible for recording activity that occurs within AMAC. DAS receives information obtained from liquidated credit unions from AMAC's Division of Liquidation of Member Services (DLMS). DAS then uploads the information on to their system and maintains credit union activity thereafter on AMAC's system. At this point, DAS is also responsible for cash receipts, disbursements, reconciliations and accounts payables related to each liquidated credit union.

At liquidation, DAS receives the liquidated credit unions' member account information and generates all of the checks to be disbursed to the members based on the liquidation memo. As accounts payable become due, they also draft the checks for disbursement to the necessary parties related to the liquidated credit unions. Payments may relate to expenses, share payouts, and asset purchases. DAS also generates subsequent journal entries related to the credit unions. In addition, if AMAC receives cash receipts, DAS is responsible for tracking and forwarding the checks to the lockbox for deposit.

We have performed procedures over Accounting Services including obtaining and reviewing written policies and procedures over the major financial processes including securing of assets, selling of other assets (e.g. FF&E), handling liabilities, purchases and acquisitions (P&A's), valuation allowances for assets, account reconciliations and journal entries. We also performed walkthroughs of these processes. The actual procedures observed during these walkthroughs were compared to the written policies and procedures and any differences or deficiencies were noted. Based on these procedures, we noted that overall AMAC has procedures and controls in place over accounting services, but noted that procedures for performing reconciliations between AMAC's records and those of the third party service provider (GILA) were not documented and formalized (Finding AS-05).

In addition, we also performed testing over account reconciliations, journal entries and payments of share accounts. This testing consisted of selecting a sample of account reconciliations and journal entries to determine if they were performed timely and contained an independent review. Our testing also entailed selecting a sample of payments of share accounts to determine checks were properly disbursed for closed accounts, that shared accounts suspected of fraudulent activity are not paid, share payments were not made to fictitious members of liquidated credit unions and that Credit Union system information is accurately input into AMAC's system.

Based on our testing procedures, we determined the following:

- AMAC does not have complete segregation of duties over cash disbursements. However, AMAC does have a mitigating control whereas Mellon bank compares



on a daily basis a report from NCUA containing all official checks to the checks cleared (Finding AS-01).

- AMAC did not always perform timely and properly supported reconciliations. Specifically, nine out of the 15 reconciliations we reviewed were performed between three days to one and one-half months after the deadline.<sup>2</sup> In addition, five out of 15 reconciliations were completed in 2010 and did not have checklists that were consistently completed with dates and sufficient documentation of preparation and/or review. Also, reconciling items between \$95 million and \$97 million that should be formally documented on a monthly basis, did not have proper support or a detailed explanation on the face of the reconciliation, nor were bank deposits reconciled to mail logs and cash receipts. Although we determined all reconciliations were completed with no errors, we found that they should be completed more timely and provide better documentation to support the reconciliation and reconciling items (Finding AS-03).
- Four out of 30 returned/voided checks we tested did not have proper documentation to support that a stop payment was placed on the check or that the check had been voided.
- Although we understand the difficult and complex nature of assuming a credit union, which often includes incomplete accounting records, we identified two credit unions assumed by the NCUA that did not have reconciliations completed in a timely manner after liquidation, approximately five months and two months after liquidation, respectively.

## **Accounting Services Findings**

### **AS-01 Segregation of Duties Over Cash Disbursements**

#### **Condition**

During our procedures over cash disbursements, we determined the same individual that can sign expense checks also has the authority to approve payment for these checks. In addition, during our expense check testing, we determined that the Financial Analyst in DAS is responsible for signing the majority of the expense checks issued. Also, we found there is no requirement for dual signatures such as the one included in the Shared Payout process (where all checks over \$100,000 require dual signatures), therefore one person is able to sign all checks of any amount.

Contradictory to written procedures, we determined two employees other than the DAS Director have access to unused check stock - the Accounts Payable Clerk and the Assistant Bookkeeper. Each of these employees is provided a small amount of unused check stock because they print checks on a regular basis. In addition, the DAS Director has custody of checks and also has signing authority which is a segregation of duties

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<sup>2</sup> The DAS checklist requires reconciliations be performed by the 20<sup>th</sup> of each month.

concern as fraudulent checks could be issued without another party's approval or review.

As a mitigating control, Mellon bank compares on a daily basis a report from NCUA containing all official checks to the checks cleared. Any discrepancies are emailed to the DAS Financial Analyst who then has the authority to approve the payment of any of these checks.

### **Criteria**

Sound internal controls dictate that organizations should maintain segregation of duties over cash disbursements whereas the employee signing checks should not have any ability to authorize the payment on those checks especially those which the bank is investigating for official approval. In addition, per Policy 755 in AMAC's Policy manual dated December 15, 2010, check stock is to be kept in locked facilities, accessible by the DAS director.

### **Cause**

The approval process for expense checks is performed through an automated database which allows approvers to authorize transactions in their queue. These approvals are logged by the system and per the client this serves as a control which compensates for the lack of requirement of dual signatures. The AP clerk is aware of the approval levels for checks which she issues, therefore, she also serves as a control point to detect any checks which have not been properly authorized by the correct individuals or have only been authorized by the Financial Analyst. However, once the checks have been issued, the Financial Analyst has the authority to approve the payment of checks which may be detected as "unofficial".

### **Effect**

In the event that collusion exists or an oversight on the part of the AP clerk occurs, checks could be authorized and signed by the Financial Analyst. In addition, the existing control which Mellon bank performs daily of the payment on possible "unofficial" checks could be circumvented since the approval of these payments go to someone with signing authority as well. Therefore, this could increase the risk of the payment of fraudulent checks. The Accounts Payable Clerk and the Assistant Bookkeeper do not have signing authority; therefore, the risk of inappropriate issuance of a check is minimized. However, having multiple people with access to unused check stock increases the likelihood that unauthorized checks can be issued.

### **Recommendations**

We recommend AMAC management:

8. Ensure all unused check stock is properly controlled in a locked facility.
9. Ensure access to check stock is limited to one individual with the potential for delegation when that individual is out of the office.

**Management Response**

Management indicated they plan to amend their policies to allow accounts payable staff to maintain a small inventory of check stock to process daily operations, noting that other than the small number of checks provided to accounts payable staff, the check stock is limited to one individual.

**OIG Response**

We do not agree with management's planned actions. Management's planned actions not only weaken internal controls over check stock, despite maintaining records of the check stock provided to staff or having the entire stock audited, but also does not control unused check stock through use of a locked facility.

## **AS-02 Liquidating Credit Union Reconciliations**

### **Condition**

Two credit unions assumed by the NCUA through liquidation, NYC OTB Federal Credit Union liquidated February 23, 2011 and Hmong American liquidated May 18, 2011, did not have reconciliations completed as of July 19, 2011, which was approximately five and two months, respectively, subsequent to the liquidations. In addition, a written procedure or standard does not exist to indicate a deadline for the completion and review of reconciliations performed for liquidations.

### **Criteria**

Reconciliations for liquidated credit unions should be performed in a timely manner. Procedures should indicate a standard deadline for these reconciliations which should be followed for all liquidations and the cause for any deviations from the timely completion of the reconciliations should be documented.

### **Cause**

Per the DAS Director, due to the complex nature of the two liquidations noted, and the possible involvement of fraud and/or missing documentation, these reconciliations could take months.

### **Effect**

Not performing timely reconciliations for liquidating credit unions increases the likelihood that irregularities within the credit union would not be found or not be found timely in order to investigate and resolve the issue.

### **Recommendation**

We recommend AMAC management:

10. Develop and institute a procedure that includes a standard timeline to complete reconciliations for liquidating credit unions and requires documented reasons for any untimely completion.

### **Management Response**

Management agrees to update its procedures to include a standard timeline completion date and additional narrative for exceptions on cases outstanding beyond the benchmark date.

### **OIG Response**

We concur with management's planned action.

### **AS-03 Timeliness and Documentation to Support Account Reconciliations**

#### **Condition**

Monthly reconciliations for major subsidiary ledgers and bank accounts are not performed in a timely manner and do not consistently contain explanations and/or sufficient support for reconciling items. Specifically, we noted:

- Nine out of the 15 reconciliations reviewed were performed between three days to one and one-half months after the 20th deadline.
- Five out of the 15 reconciliations were for 2010 at which time the report review checklist was not consistently completed with dates and sufficient documentation of preparation and/or review.
- Reconciling items between \$95 million and \$97 million, for the three months reviewed, did not have proper support or detailed explanation on the face of the reconciliation.
- Lastly, during the monthly reconciliation process, bank deposits are reconciled to mail logs and cash receipts, however, this process is not formally documented on a monthly basis.

#### **Criteria**

Accounting Services personnel are supposed to perform reconciliations by the 20th of the following month according to the report review checklist, which the Division of Accounting Services uses to document the dates of preparation and review for reconciliations. In addition, reconciling items should contain sufficient explanation and support for larger amounts on the reconciliation. Lastly, the reconciliation of deposits to mail logs and cash receipts as described in the Accounting procedures should be documented on a monthly basis to display the results of this reconciliation.

#### **Cause**

Due to various factors, specifically depending on areas of need in the business, reconciliations may not always be performed timely by the 20th deadline. In addition, the explanation and confirmation of reconciling items may be discussed within AMAC internally without being fully documented on the face of the reconciliation.

#### **Effect**

The untimely completion of reconciliation as well as the lack of documentation surrounding reconciling items could lead to inaccurate or untimely information.

#### **Recommendations**

We recommend AMAC management:

11. Ensure that the Division of Accounting Services performs reconciliations by the 20th of each month as set by the Division of Accounting Services checklist.

12. Ensure that reconciling items are explained and documented sufficiently on the face of the reconciliation.
13. Ensure reconciliations are documented to mail logs and that cash receipts are reconciled to bank deposits and are included with the bank reconciliations on a monthly basis.

### **Management Response**

Management agreed with the recommendations and acknowledged that timely reconciliations are important and that AMAC continuously works with NCUA's Office of the Chief Financial Officer to ensure timely completion. Management also indicated they would expand the explanation on extremely large reconciling items and will evaluate the value of consolidating reconciliations.

### **OIG Response**

Although management agreed with the recommendations, management did not completely address each of the three recommendations to ensure (1) reconciliations are completed by the 20th of each month, (2) *all* reconciling items are explained on the face of the reconciliation (not just extremely large reconciling items), and (3) reconciliations are documented to mail logs and bank deposits and are included with the monthly bank reconciliations, rather than evaluating the value of consolidating them. The OIG will follow up in six months to determine what specific actions have been taken to address these recommendations.

## **AS-04 Reconciliation of Loans Between NCUA's Records and Gila's**

### **Condition**

During our on-site visit, we noted that NCUA's records and Gila's records contained differences in loan balance information for approximately 700 loans.

### **Criteria**

Sound internal controls dictate that reconciliations should be performed between an organization's record and those of its service provider to help ensure that provider is properly accounting for and maintaining financial data.

### **Cause**

During our review, we learned the Division of Accounting Services was in the process of reconciling the system. However, none of the reconciliations were completed between the two systems. Per inquiry with AMAC, it is believed that the majority of the differences are due to timing for posting payments between AMAC and Gila.

### **Effect**

Not completing timely reconciliations between internal loan balances records and those of the third party service provider could result in errors to loan balances not being detected by AMAC management.

### **Recommendation**

We recommend AMAC management:

14. Ensure the Division of Accounting Services performs and documents reconciliations between internal loan balances and those of the third party service providers, with any differences noted during the completion of the reconciliations investigated and resolved.

### **Management Response**

Management agrees and indicated they have reconciled with the third party servicer since the inception of the relationship. A reconciliation was completed as of December 2011, differences were resolved and a process was established to correct any future differences in a timely manner.

### **OIG Response**

We concur with management's actions taken and planned.

## **Liquidation Services**

AMAC's Division of Liquidation of Member Services (DLMS) is responsible for the beginning of the overall liquidation process. DLMS executes liquidation orders by sending an individual to designated credit unions and securing all assets on site. They notify credit union employees of the events that are taking place and obtain credit union records and belongings to bring back to AMAC's office. DLMS then drafts the liquidation memo to be sent to DAS outlining how customer accounts are to be reimbursed and distributed. If liquidation is performed under a purchase and acquisition with a third party, the employee from DLMS works with the third party to have the assets transferred to their possession.

We have performed procedures over the DLMS including on-site procedures, securing of assets, selling of other assets (e.g. FF&E), handling liabilities, and purchase and acquisitions. We also performed walkthroughs of these processes. We compared the actual procedures observed during these walkthroughs to AMAC's written policies and procedures and noted any differences or deficiencies. Based on these procedures, we determined that overall; AMAC has procedures and controls in place over the DLMS, but does not currently have one consolidated liquidation manual. AMAC used several documents, some of which the manuals were outdated. In addition, we noted that a formal liquidation checklist was not consistently used. Specifically, we sampled ten liquidated credit unions and noted a checklist was not provided for three out of the ten credit unions.

In addition, we also performed testing to determine whether liquidated credit unions were approved and were liquidated in a timely manner. Based on these procedures, we identified no exceptions during our testing.

## **Liquidation Services Findings**

### **LS-01 - Written Liquidation Procedures**

#### **Condition**

Multiple documents contain procedures and those procedures are only advisory in nature. Current procedures, including Examiners Guide to On-site Liquidation Procedures (NCUA Publication Oct 2001), Involuntary Liquidation and Payout Procedures, and Research Desktop Procedures, are used by analysts as reference only, and only to the extent they don't contradict policy.

#### **Criteria**

Sound internal controls dictate that policy and written procedures exist and are communicated to affected employees.

#### **Cause**

Based on a communication from the Director of the Division of Liquidation and Member Services and from discussion with management, AMAC policy and procedures are in



the process of being rewritten. Once this project is completed, those procedures will replace the procedures existing now, which are recognized by management as not being comprehensive. The project of rewriting the policy and procedures has been in process since before January 2010.

### **Effect**

Without consistent and enforced policy and procedures, there is increased risk that employee turnover would result in the process being performed incorrectly. There is also increased risk that controls in the process are missed due to inconsistent approach.

### **Recommendations**

We recommend AMAC management:

15. Consolidate in a comprehensive manner, all existing procedures to remove any conflicting or redundant information.
16. Include references to procedures in the policy, with approval by management (with greater authority than the highest level employee bound by policy) documented on an annual basis.
17. Ensure all existing procedures are communicated and made available to all employees.

### **Management Response**

Management agrees in principle with the recommendations and noted they are in the process of converting AMAC policies and procedures into NCUA's "instruction" format. Management also indicated that as updates are made, they are formally communicated to staff and training is provided if necessary.

### **OIG Response**

We concur with management's actions taken and planned.

## **LS-02 On-site Liquidation Checklist**

### **Condition**

We determined three out of ten liquidated credit unions in our sample had on-site liquidation phases. Only one of the three had a completed on-site checklist and none of the three had any evidence that a review was performed for the completeness of the checklist documentation. For seven out of ten liquidations in our sample, there was no evidence that a timely review was performed for the compensatory two-month documentation checklist. This review was performed in batches in June 2011 for liquidations as far back as August 2010.

### **Criteria**

Sound internal controls dictate that a review for required documentation should be completed timely. Current policy refers to an on-site checklist, and has an example attached. Current procedure relies on a documentation checklist completed at the two-month point. A check for required documentation should be performed and documented for all liquidations with timely review.

### **Cause**

According to the Director of the Division of Liquidation and Member Services, completion of the checklist is not required by policy and is used by the Liquidation Analysts as a tool at their discretion, with each Analyst modifying the checklist for his/her use depending on the needs of the job. The two-month checklist is intended to serve the same purpose, to ensure documentation is complete within a timeframe in which missing documents could reasonably still be gathered. Completion of this checklist is not mentioned in policy either. There is no evidence that the two-month checklist is reviewed in a timely manner. The Director, DLMS, took over this responsibility in January 2011, and has not caught up. For a standardized checklist to be effective, it should be well-worded, prioritized, and broken out by type of liquidation. The checklist should be driven by policies and procedures, which are in the process of being updated and standardized. Checklists should be identified in policy and reviewed in a timely manner. In addition, AMAC management believes that the experience level of the liquidation analysts is sufficient that a checklist would not be required and reviews of said checklist would not be necessary.

### **Effect**

Without a consistent checklist and a timely review, necessary steps in the on-site liquidation process may be overlooked. Without a timely review, documentation missing from the liquidation files may not be noticed before the opportunity to gather the affected documents has passed, leading to incomplete documentation of the liquidation.

### **Recommendations**

We recommend AMAC management:

18. Develop a standardized liquidation policy that is prioritized, clear, and complete.
19. Ensure the two-month documentation checklist be codified and attached in policy and reviewed by management for completeness as soon as possible, within two months of completion, or sooner depending on circumstances of the liquidation, with signatures from preparer and reviewer.

### **Management Response**

Management agrees liquidation process policies are needed. In addition, management agrees to incorporate the two month checklist into their policy.

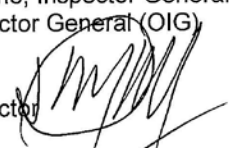
### **OIG Response**

We concur with management's planned actions.

## Appendix A – Management Response

AMAC/OOP/DGK:dk  
SSIC 1920

TO: William DeSarno, Inspector General  
Office of Inspector General (OIG)

FROM: Dave Marquis  
Executive Director 

SUBJECT: Management Comments on the OIG Audit of the Asset Management  
Assistance Center (AMAC)

DATE: March 12, 2012

This memorandum responds to your request for official comments on the OIG draft report titled *Audit of Asset Management Assistance Center*.

We agree with the general content of the report and with many of the recommendations contained in the Report. In many cases we are already taking action where appropriate. Given the large increase in assets overseen by AMAC in the past few years, we agree additional documentation and retention is prudent. We are continually updating our policies, procedures, and processes to meet these challenges.

Our responses to the report recommendations are in the attached document titled *Response to the Audit of Asset Management Assistance Center*.

Attachment

**Response to the Audit of the Asset Management Assistance Center**

**AR-01 REO Valuation Support**

**Recommendations**

We recommend AMAC management:

1. Obtain appraisals or document valuation of all properties transferred into Real Estate Owned to support the fair value being transferred to REO.
2. Review and document all appraisals in excess of \$250,000 to ensure that the appraiser is independent and to verify that the support for the valuation is adequate.

**Management Response**

We agree to capture more detailed documentation on the value of each property being transferred to REO. AMAC currently obtains a Broker Price Opinion (BPO) or appraisal for each property or uses a portfolio approach based on the house model (e.g., location, square footage, amenities, etc.) and obtains a BPO for homogenous properties to determine the net realizable value (NRV). The methodology of valuing the Florida houses is consistent across the entire portfolio and the valuation of each property is recorded in a database. This approach is consistent with AMAC policies and procedures.

We agree to formalize the review of appraisals in excess of \$250,000.

We would like to specifically respond to the "Effect" listed under this item. The report states:

*"Due to the fragile housing market, borrowers who receive a cancellation of debt as a result of AMAC repossessing the asset affects the value of the property on AMAC's records as well as the balance sheet because amounts reported for cancellation of debt may be misstated without proper supporting documentation for the valuation of the properties and review of the appraisals used to validate the anticipated value."*

In only one case in Florida has a court questioned our valuation of a property in a foreclosure proceeding. In that particular case, we obtained a full appraisal which was accepted by the court. The appraisal was actually lower than the BPO which was to the detriment of the borrower.

**AR-02 Valuation Documentation**

**Recommendation**

We recommend AMAC management:

3. Perform and document their analysis when determining whether to maintain properties versus selling them in a bulk sale, this would also include documenting potential financial outcomes for both options to support their decision-making.

**Management Response**

We agree to more clearly document our decisions. We have already taken steps to improve the compilation and retention of information to support major decisions.

In regard to the Florida properties, due consideration was given to the best course of action for disposing of the assets. Due to the extensive number of properties, considerations existed beyond just the immediate value on the sale of the properties. Flooding the market with over 800 REOs during the declining market cycle would have serious repercussions on credit unions with operations in the local area.

The bulk sale of 100 properties was attempted, but pursuing the bulk sale of all the properties was never contemplated. Our view is the acceptance or rejection of selling the first 100 properties did not make a significant difference in the outcome of cases.

These 100 properties were some of the best assets in the Florida portfolio. We had no expectation of a similar return if these sales results were extrapolated across the remaining portfolio. It should also be noted that a sale would not have prevented us from incurring significant legal costs related to defending against lawsuits related to these properties.

It is important to remember the potential sale at 32% of the asset value is highly speculative. The group bidding at 32% also submitted the earlier high bid of 40%. The group didn't close at 40% and it is uncertain whether they would or could have closed at 32%.

The projected losses on the Huron and Norlarco liquidations primarily resulted on the properties in Florida. The losses listed below relate to the overall losses expected on the cases. We originally valued the loan portfolios in these two cases using the 32% bid as a benchmark. Though a speculative benchmark, it was the best information available at the time. Looking at the initial and current loss figures in the table below depicts a positive change in the loss estimates.

Credit Union	Original Loss	Current Loss	Change	% Change
Huron River	\$38,732,112	\$42,547,305	(\$3,815,193)	-9.9%
Norlarco	\$10,050,000	\$4,032,684	\$6,017,316	59.9%
Total	\$48,782,112	\$46,579,989	\$2,174,645	4.5%

AMAC routinely makes sell/hold decisions and these are made based upon the best information available at the time. AMAC staff along with regional examination staff performed an extensive analysis on the Florida portfolio in December 2007. AMAC staff involved with the decision performed site visits in Florida and inspected many of the houses. We made this decision with the best information available at the time.

#### **AR-03 REO Cost to Carry Evaluation**

##### **Recommendation**

We recommend AMAC management:

4. Formalize the cost to carry evaluation process for Real Estate Owned so that at any given point in time, management can analyze and compare market prices of a property to the cost to carry that property and determine whether to sell or hold the property.

##### **Management Response**

We agree to enhance the documentation and formalize the 'cost to carry' analysis performed at a macro level. AMAC will use data from the general ledger as well as data from the REO database to perform a 'cost to carry' analysis that will support management's decision to sell or hold properties. Formal documentation of the decision will be retained.

#### **AR-04 Accounts with Attorneys**

##### **Recommendation**

We recommend AMAC management:

5. Complete reconciliations for accounts with attorneys on a periodic basis, but at a minimum on a quarterly basis.

##### **Management Response**

We agree to apply the recommendation on all future engagements. AMAC is currently in the process of unwinding its only remaining loan collection agreement with a single outside attorney. Over the last three years, AMAC only collected \$15,000 under this agreement. It is expected that the wind-down process will be completed within the next month.

**AR-05 Approvals for Disposed Assets**

**Recommendation**

We recommend AMAC management:

6. Document the delegation of authority along with the actual approval for the disposition of all REO assets.

**Management Response**

We agree with the recommendation. AMAC will continue to monitor that approvals are fully documented and maintained. They confirmed the two dispositions referenced were properly approved. They located documentation to support one of the approvals while the other approval was verbal and not formally documented. In both cases, the closing documents were signed by the authorized staff member.

**AR-06 Review of Servicer Auditor Report for Loan Provider**

**Recommendation**

We recommend AMAC management:

7. Perform and document a review of Servicer Auditor Reports to ensure any material control weaknesses of that service provider are acknowledged and analyzed and to ensure that user controls are identified and in-place at AMAC.

**Management Response**

We agree that a review of the Servicer Auditor Reports should be performed.

On January 10, 2012, AMAC received a SSAE 16 report covering the period October 2010 to September 2011. This was the first SSAE report that covered the period where AMAC had contracted with the outside servicer. They completed and documented the review of this report. They will continue to review the SSAE 16 on an annual basis.

**AS-01 Segregation of Duties Over Cash Disbursements**

**Recommendations**

We recommend AMAC management:

8. Ensure all unused check stock is properly controlled in a locked facility.
9. Ensure access to check stock is limited to one individual with the potential for delegation when that individual is out of the office.



### **Management Response**

We agree to amend our policies to note that it is permissible for accounts payable staff to maintain small inventories of check stock to process daily operations. Additionally, records are currently maintained of the check stock that is supplied to the check issuers, and the entire stock is audited.

Other than the small number of checks noted above, which is essential for the daily flow of operations, the check stock is limited to one individual. That access is delegated in the event of an extended absence of the division director.

### **AS-02 Liquidating Credit Union Reconciliations**

#### **Recommendation**

We recommend AMAC management:

10. Develop and institute a procedure that includes a standard timeline to complete reconciliations for liquidating credit unions and requires documented reasons for any untimely completion.

#### **Management Response**

While we do track the completion status of the reconciliations, we agree to update the reports to include a standard timeline for completion with additional narrative for exceptions on cases outstanding beyond the benchmark date.

It is important to clarify these are not reconciliations of NCUA's own general ledger accounts, but are reconciliations of the records of liquidated credit unions. Additionally, the cash accounts of liquidated credit unions are routinely closed soon after liquidation, so there is minimal risk to loss of funds.

### **AS-03 Timeliness and Documentation to Support Account Reconciliations**

#### **Recommendations**

We recommend AMAC management:

11. Ensure that the Division of Accounting Services performs reconciliations by the 20th of each month as set by the Division of Accounting Services checklist.
12. Ensure that reconciling items are explained and documented sufficiently on the face of the reconciliation.

13. Ensure reconciliations are documented to mail logs and that cash receipts are reconciled to bank deposits and are included with the bank reconciliations on a monthly basis.

**Management Response**

We agree that timely reconcilments are important and AMAC is working continuously with the Office of the Chief Financial Officer (OCFO) to ensure reconcilments and reports are completed in a timely manner.

We agree to expand the explanation on extremely large items. The item noted in the Condition Section was known and understood by the users of the reconciliation. The item existed only because of a timing situation in the deconsolidation process and did not represent any missing or un-posted funds.

We agree to evaluate our reconciliation process to determine the value of consolidating the reconciliations. The items described are reconciled separately, so both reconciliations are needed to understand the full picture.

During the first half of 2011 there was a significant change in AMAC's accounting and reporting environment due to the deconsolidation of AMAC's financials from those of the NCUSIF. As part of this changeover process, there were a number of needed restatements and additional reconcilments between AMAC and OCFO. The reconciliations could not be prepared until after the records at AMAC and OCFO were officially closed for the month, thus the reconciliations were delayed. We were aware the delay was part of the overall deconsolidation process. This process was completed in July 2011. Reconciliations are being completed in a timely manner with the completion timeframes tracked by management.

**AS-04 Reconciliation of Loans Between NCUA's Records and Gila's**

**Recommendation**

We recommend AMAC management:

14. Ensure the Division of Accounting Services performs and documents reconciliations between internal loan balances and those of the third party service providers, with any differences noted during the completion of the reconciliations investigated and resolved.

**Management Response**

We agree and have been in process of reconciling with the third party servicer since the inception of the relationship. AMAC began using Gila LLC to provide collection and payment processing services in 2011. They determined that parallel processes would be used as part of the transition process so they could ensure that Gila was posting loan transactions correctly. They completed the reconcilment as of December 2011,

resolved the differences, and set up a process to correct any future differences in a timely manner.

#### **LS-01 - Written Liquidation Procedures**

##### **Recommendations**

We recommend AMAC management:

15. Consolidate in a comprehensive manner, all existing procedures to remove any conflicting or redundant information.
16. Include references to procedures in the policy, with approval by management (with greater authority than the highest level employee bound by policy) documented on an annual basis.
17. Ensure all existing procedures are communicated and made available to all employees.

##### **Management Response**

We agree in principle with the recommendations. Policy and procedure updates are a continuous process. We are in the process of converting AMAC policies and procedures to the NCUA instruction format to comply with NCUA Instruction 1800.2. As updates are made, they are formally communicated to staff and training provided if necessary.

#### **LS-02 On-site Liquidation Checklist**

##### **Recommendations**

We recommend AMAC management:

18. Develop a standardized liquidation policy that is prioritized, clear, and complete.
19. Ensure the two-month documentation checklist be codified and attached in policy and reviewed by management for completeness as soon as possible, within two months of completion, or sooner depending on circumstances of the liquidation, with signatures from preparer and reviewer.

##### **Management Response**

We agree policies are needed to cover the liquidation process. The liquidation itself is subject to Federal Statutes, Agency Rules & Regulations, and Delegated Authorities, which provide the framework for each liquidation. These documents allows for the necessary professional judgment of each liquidation analyst to carry out the liquidation.

We agree to incorporate the two month checklist in our policy. A review of the file(s) by staff other than the analyst is already performed two months following liquidation. This helps early identify deficiencies in the liquidation process to allow corrections as necessary. The two month checklist is reviewed by management as a quality control.