VA Office of Inspector General

OFFICE OF AUDITS AND EVALUATIONS

Veterans Benefits Administration

Audit of
Liquidation Appraisal Oversight
Cleveland and Phoenix
Regional Loan Centers

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ACRONYMS AND ABBREVIATIONS

AMS/AVMS	Appraisal Management System/Automated Valuation Model Services
CAP	Corrective Action Plan
ICM	Internal Control Management
LGY	Loan Guaranty
LoanSTAR	Loan Systematic Technical Accuracy Review
OIG	Office of Inspector General
RLC	Regional Loan Center
SAR	Staff Appraiser Reviewer
VBA	Veterans Benefits Administration

Report Highlights: Audit of VBA's Liquidation Appraisal Oversight, Cleveland and Phoenix Regional Loan Centers

Why We Did This Audit

In FY 2011, the Veterans Benefits Administration's (VBA) Loan Guaranty (LGY) Program paid just over $1.4 billion to acquire about 14,000 foreclosed real estate properties. The Office of Inspector General (OIG) conducted this audit to evaluate the effectiveness of Regional Loan Center (RLC) oversight of liquidation appraisals and to follow up on our 2009 audit that found LGY Service needed to improve risk management.

What We Found

The Cleveland and Phoenix RLCs needed to improve liquidation appraisal oversight. RLC staff did not consistently review liquidation appraisal comparable property selections and sales price adjustments needing further review.

Cleveland and Phoenix RLC staff did not conduct these reviews because LGY Service policies and procedures did not include sufficient criteria for RLC staff to evaluate every appraisal. In addition, LGY Service did not use an automated appraisal review tool. As a result, VA may not pay fair and reasonable prices when acquiring properties.

Although LGY Service had initiated a Risk Management Program, LGY Service must take further actions to strengthen risk management. During FY 2010, LGY Service did not analyze internal control test results, develop corrective action plans, or conduct ongoing monitoring. During FY 2011, LGY Service still had not completed some important risk management actions. Consequently, threats to accomplishing LGY Service goals and objectives may go undetected until significant problems develop.

What We Recommended

We recommended that the Under Secretary for Benefits revise LGY Service policies and procedures, use an automated appraisal review tool, fully implement LGY Service's Risk Management Program, and revise LGY Service managers' performance plans.

Agency Comments

The Under Secretary for Benefits did not agree with Recommendation 1, but agreed with Recommendations 2–4. Nonetheless, the Under Secretary stated VBA would implement an appraisal review tool for exception-based oversight, which will meet the intent of Recommendations 1 and 2. The Under Secretary also stated VBA had implemented LGY Service's Risk Management Program and revised performance plans for LGY Service managers. In general, the Under Secretary expressed significant concerns with our report and did not agree with many of our conclusions.

OIG Comments

We continue to strongly believe the audit evidence sufficiently and appropriately provides a reasonable basis for our findings and conclusions. We will follow up on implementation of the corrective actions.

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Assistant Inspector General
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INTRODUCTION

Objective

The audit evaluated the effectiveness of Cleveland and Phoenix Regional Loan Centers' (RLC) oversight of real estate liquidation appraisals and followed up on our April 2009 audit that found Loan Guaranty (LGY) Service needed to improve risk management.

LGY Program Mission

LGY Service administers the LGY Program mission of assisting eligible service members, veterans, and surviving spouses to purchase and retain real estate properties. A key component of the mission is to guarantee portions of lender loans obtained to purchase real estate properties.

Recent Reorganization

Effective April 2011, the VA Secretary reorganized the Veterans Benefits Administration (VBA) headquarters to increase oversight of all major program areas, including LGY Service. The Secretary assigned a new Deputy Under Secretary for Economic Opportunity responsibility for oversight of Education, LGY, and Vocational Rehabilitation and Employment Services. Prior to April 2011, the Associate Deputy Under Secretary for Policy and Program Management was responsible for LGY Service.

Regional Loan Centers

Nine RLCs provide oversight of the appraisal process. The Cleveland and Phoenix RLCs completed almost 9,500 (24 percent) of the nearly 40,000 liquidation appraisals finished during FY 2011. LGY Service policies and procedures require RLC staff to conduct desk reviews of selected liquidation appraisal reports to ensure they are complete, consistent, logical, and include descriptions of appraisal methodologies and conclusions. RLC staff perform field reviews of 10 percent of appraisals. Field reviews must also include observations of subject and comparable property characteristics. (Appendix A provides additional details on the LGY Program mission, liquidation appraisals, and RLC oversight.)

Liquidation Appraisals

Real estate appraisals are professional opinions of property fair market value at a certain point in time. When loan defaults occur on guaranteed properties, LGY Service assigns contract appraisers to conduct liquidation appraisals of the properties. Contract appraisers have broad discretion to apply their professional judgment in establishing fair market values. During FY 2011, contract appraisers conducted about 40,000 liquidation appraisals of properties with values totaling just over $5 billion. Federal law requires VA to use appraisal fair market values when determining whether to acquire foreclosed properties and the amount to pay lenders for acquired properties. A contractor manages and sells acquired properties for VA. During FY 2010, VA sold almost 16,000 properties at a loss of nearly $370 million. In FY 2011, VA sold about 16,400 properties, slightly more than FY 2010, while losses increased nearly 22 percent to almost $450 million.

RESULTS AND RECOMMENDATIONS

Finding 1 Improved Oversight Will Help Ensure VA Pays Fair and Reasonable Prices for Foreclosed Properties

Increasing the effectiveness of Cleveland and Phoenix RLC oversight of liquidation appraisals will help ensure VA pays fair and reasonable prices when acquiring real estate properties. For 35 of 47 sampled Cleveland and Phoenix RLC liquidation appraisals, RLC staff did not sufficiently review comparable property selections and comparable property sales price adjustments that had potential to affect subject property valuations.

For 31 of the 35 appraisals, Cleveland and Phoenix RLC staff did not identify the comparable property selections, adjustments, or nonadjustments needing further review. For the four remaining appraisals, Cleveland and Phoenix RLC staff identified comparable property selections, adjustments, or nonadjustments needing further review, but they did not conduct the reviews. This inadequate oversight occurred because LGY Service:

- Did not use an automated quality control tool to review appraisals
- Policies and procedures did not include sufficiently specific criteria for evaluating comparable property selections and price adjustments

As a result, there are increased risks that VA will not pay a fair and reasonable price when acquiring foreclosed properties.

Cleveland and Phoenix RLC staff agreed the comparable property selections, adjustments, and nonadjustments we identified needed further review. These RLC employees were subject matter experts who had several years of experience, knowledge, and familiarity with local real estate markets. However, LGY Service senior appraisers in VA Central Office did not agree with the RLC subject matter experts that all the appraisals needed further review. The inconsistency between VA Central Office staff and RLC staff further illustrates the need for LGY Service policies and procedures to include sufficiently specific criteria for evaluating comparable property selections and price adjustments.

Comparable Property Selections

For 6 of the 47 sampled Cleveland and Phoenix RLC liquidation appraisals, RLC staff needed to conduct further reviews of comparable property selections. Selecting appropriate comparable properties is an important step of the appraisal process to ensure property valuations are fair and reasonable. LGY Service policies and procedures require contract appraisers to use the sales comparison approach when determining property values. The sales comparison approach requires appraisers to select at least three properties that are comparable with the subject property. LGY Service policies and procedures also require appraisers to not restrict comparable property selections to properties solely in similar conditions as the subject property. A property in a different condition than the subject property may be a better indicator of value with proper sales price adjustments.

LGY Service policies delineate three main factors in selecting the best comparable properties. First, sales prices for the three comparable properties should be within a narrow price range. Second, sales dates of comparable properties typically should be within 6 months prior to the subject property appraisal date. Third, comparable properties should be in close proximity to the subject property. The comparable property selections needing further RLC staff review were instances where a national real estate database reported a different property sale that met at least two of the three main factors better than the property selected by the appraiser.

For the six liquidation appraisals with comparable property selections needing further review, potentially better comparable properties were available than the properties selected by the appraiser. The following example highlights an appraisal report RLC staff needed to review further to ensure VA paid a fair and reasonable price for the property.

> In August 2010, a contract appraiser valued a subject property located in Ohio at $83,000. The appraisal report showed the appraiser selected three comparable properties that sold in August 2009 (two properties) and May 2010 (one property) with about a 31 percent price variation ranging from $80,000 to $104,500. However, a real estate database showed two potentially better comparable properties. These properties sold in June and July 2010, which were more recent, and when combined with the property that sold in May 2010 had a significantly smaller price range of $12,000 (18 percent) from $68,000 to $80,000. Because RLC staff did not conduct further reviews of the comparable property selections, VA may not have paid a fair and reasonable price for the property.

To improve the oversight of liquidation appraisals and help ensure fair and reasonable liquidation property valuations, LGY Service needs to revise policies and procedures to require an evaluation of all contract appraiser comparable property selections. This evaluation must include the use of independent data sources, such as county property tax records and multiple listing services, to evaluate the appropriateness of comparable property selections. A multiple listing service is a database maintained by a group of real estate brokers to provide information about properties for sale.

Adjustments and Nonadjustments

After selecting sold properties to compare with the subject property, appraisers adjust comparable property sales prices for characteristic differences. For 35 of 47 sampled Cleveland and Phoenix RLC liquidation appraisals, RLC staff needed to conduct further reviews of 99 adjustments or nonadjustments related to comparable property sales prices (30 adjustments and 69 nonadjustments).

- The 30 adjustments were instances where a real estate database or county records indicated an appraisal adjustment for a comparable property characteristic should possibly have been a higher or lower dollar amount.
- The 69 nonadjustments were instances where the appraisal report did not include any dollar adjustment for a significant comparable property characteristic difference from the subject property.

Individual appraisals had up to 10 adjustments or nonadjustments RLC staff needed to further review. For 8 of these 99 property characteristics, RLC staff did identify the adjustments or nonadjustments but they did not conduct further reviews. The adjustments and nonadjustments were for characteristic differences between subject and comparable properties such as room counts, gross living areas, site size, and declining market conditions.

Adjusting comparable property sales prices is an important step of the appraisal process to ensure property valuations are fair and reasonable. The sales comparison approach requires appraisers to adjust comparable properties' sales prices to compensate for differences between subject and comparable property characteristics.

When significant property characteristic differences exist between the subject and comparable properties, appraisers must add or subtract dollar amounts from comparable property sales prices to determine adjusted sales prices. LGY Service policies require the appraised value of a subject property to not exceed the highest adjusted sale price of three comparable properties.

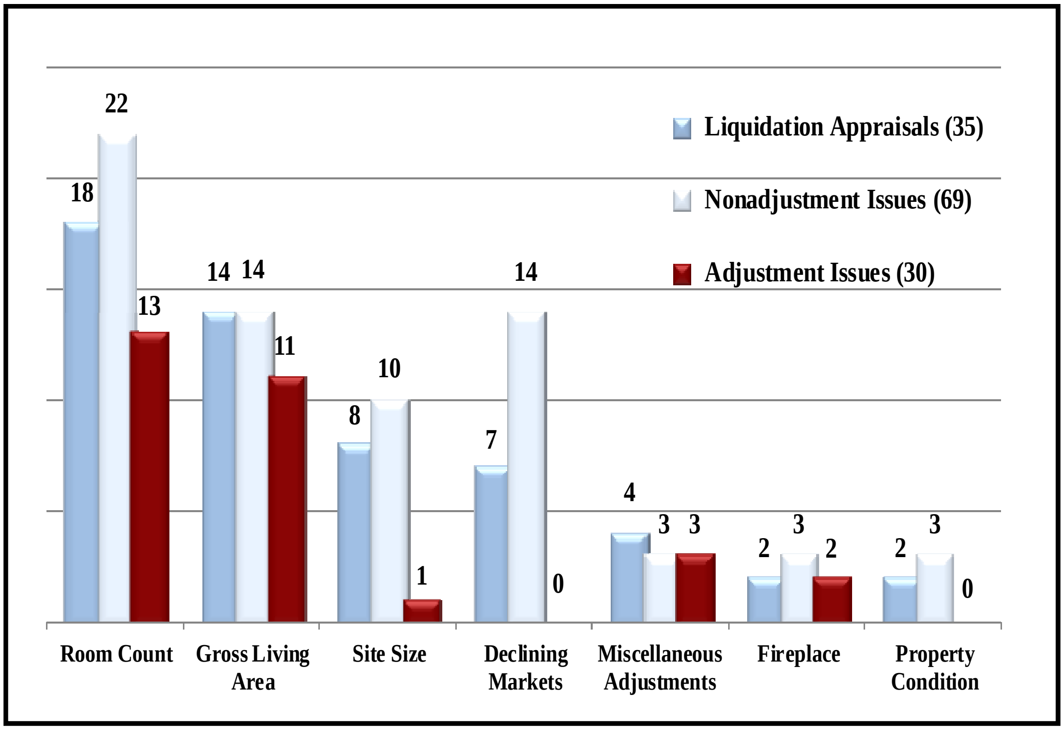
LGY Service policies and procedures require contract appraisers to complete an appraisal report when performing liquidation appraisals. The appraisal report lists more than 25 different property characteristics appraisers must consider when comparing subject and comparable properties.

These characteristics include location, age, fireplaces, and quality of construction. LGY Service policies and procedures also require appraisers to record the sources of property characteristic information. Possible sources include physical inspections and county property tax records.

Figure 1 that follows, shows the number of sampled appraisals with adjustments or nonadjustments RLC staff needed to review further. Some appraisals had adjustments or nonadjustments needing further review for multiple characteristics.

Figure 1

Sampled Cleveland and Phoenix RLC Appraisals With Adjustments or Nonadjustments Needing Further RLC Staff Review



Source: VA OIG analysis of real estate liquidation appraisals

The following examples related to room counts and gross living areas highlight how RLC staff need to further review liquidation appraisal adjustments to help ensure VA pays a fair and reasonable price when acquiring foreclosed properties. (See Appendix C for additional examples of liquidation appraisals needing further review.)

Room Counts

Eighteen sampled liquidation appraisals had a total of 35 adjustments or nonadjustments for room count differences RLC staff needed to review further (13 adjustments and 22 nonadjustments). LGY Service policies and procedures require appraisal reports to include the total number of rooms, bedrooms, and bathrooms for the subject and comparable properties. The following example highlights a nonadjustment related to the number of bathrooms in a property appraisal.

> A contract appraiser valued a subject property located in California at $185,000. The appraisal report showed one comparable property had 2.5 bathrooms. Our review of county tax records showed the comparable property had 3.5 bathrooms. However, the appraiser did not make an adjustment for the 1.0 bathroom difference.

Gross Living Area

Fourteen sampled liquidation appraisals, had a total of 25 adjustments or nonadjustments related to gross living area square footage differences RLC staff needed to review further (11 adjustments and 14 nonadjustments). LGY Service policies and procedures require appraisal reports to show the gross living area square footage for subject and comparable properties. The gross living area adjustments or nonadjustments related to subject and comparable property square footage differences as large as 334 square feet. The following examples highlight an appraisal report adjustment and nonadjustment RLC staff needed to review further to ensure VA paid fair and reasonable prices for the properties.

> **Adjustment—**A contract appraiser valued a subject property located in New Mexico at $155,000. The appraisal report showed the subject property gross living area was 2,543 square feet and made three comparable property sales price adjustments of $8,260, $1,960, and $1,140 for gross living area square footage differences. However, county property tax records and a subsequent appraisal performed by another contract appraiser showed the subject property gross living area was only 2,418 square feet, a difference of 125 square feet from the appraisal performed by the first contract appraiser. The appraisal report showed the gross living area was valued at $20 per square foot, which would equate to a possible $2,500 inaccurate sales price adjustments for all three comparable properties used.

> **Nonadjustment—**A contract appraiser valued a subject property located in California at $303,000. The appraisal report showed the gross living area was 2,938 square feet for the subject property and 3,028 for one of the comparable properties. The appraisal report also showed the gross living area was valued at $35 per square foot. However, the report did not show an adjustment for the 90 square feet difference (value equaled $3,150).

Although some of the 99 adjustments and nonadjustments may have been appropriate, LGY Service oversight did not provide reasonable assurance they were appropriate. LGY Service needs to improve oversight of liquidation appraisals to ensure RLC staff identify the type of adjustments and nonadjustments highlighted in this report and question contract appraisers about the appropriateness of the adjustment or nonadjustment.

LGY Service managers told us they rely extensively on contract appraisers' professional opinions and do not want to introduce any policies or procedures that might impair these opinions. However, LGY Service must protect VA's interests and ensure oversight of appraisals is sufficient to provide reasonable assurance of accurate property valuations. LGY Service can obtain this assurance by establishing specific criteria for comparable property sales price adjustments and require contract appraisers to provide justification for variances from the criteria.

Inadequate Evaluation of Comparable Properties

Cleveland and Phoenix RLC staff did not identify comparable property selections, adjustments, and nonadjustments that needed further review because LGY Service policies and procedures did not require evaluations of all appraisals' comparable property information. Generally, RLC staff accepted comparable property information in the appraisal report without checking property information reported by other sources. Independent data sources can be useful tools when evaluating liquidation appraisal comparable property information. These sources, such as county property tax records, national real estate databases, and multiple listing services, provide property information, such as room counts, gross living area square footage, and site sizes, that reviewers can compare with appraisal property information.

Inadequate Criteria for RLC Staff

Cleveland and Phoenix RLC staff also did not identify comparable property selections, adjustments, and nonadjustments that needed further review because LGY Service policies and procedures did not include sufficiently specific criteria for evaluating comparable property selections and prices. RLC staff and managers considered LGY Service policies and procedures inadequate because they did not provide sufficient details to help them consistently evaluate comparable property information affecting appraisal valuations. They also stated LGY Service policies and procedures relating to the comparable property selections and characteristics, discussed in this report, were too subjective and LGY Service needs to issue guidance that is more definitive.

Discussed below are examples of how LGY Service can improve criteria related to comparable property selections and adjustments to comparable property sales prices for gross living area, site size, and declining market conditions.

Comparable Property Selections

LGY Service policies and procedures did not provide sufficient criteria on selecting the best comparable properties for liquidation appraisals. LGY Service policies delineate the following three main factors in selecting the best comparable properties.

- Comparable property sales prices should be within a narrow price range.
- Sales dates of comparable properties typically should be within 6 months of subject property appraisal dates.
- Comparable properties should be geographically located within close proximity to subject properties.

However, LGY Service policies and procedures did not require appraisers to provide explanations that include their considerations of these three factors in their comparable selections.

For example, LGY Service policies and procedures did not define the parameters of what constitutes a narrow price range and did not require appraisers to provide justifications when selecting comparable properties outside defined parameters. For the 47 sampled appraisals, comparable property price ranges averaged 21 percent and the highest was 72 percent. The wide variance in comparable property price ranges demonstrates why LGY Service needs to strengthen comparable property sales prices criteria. Without more specific criteria, LGY Service will not have reasonable assurance that appraisers have selected the best comparable properties.

Gross Living Area

LGY Service policies and procedures did not provide sufficient criteria on the amount and/or percent of gross living area square footage differences between subject and comparable properties that require adjustments or an explanation of the appraiser's decision not to make adjustments. For the 47 sampled appraisals, appraisers adjusted comparable property sales prices for gross living area differences as small as 10 square feet or 0.6 percent ($200 adjustment), while other appraisers did not make adjustments for differences as large as 90 square feet or 3.1 percent (value equaled $3,150).

Site Size

LGY Service policies and procedures did not provide sufficient criteria on the amount and/or percent of property site size differences between subject and comparable properties that require adjustments or an explanation of the appraiser's decision not to make adjustments. For the 47 sampled liquidation appraisals, appraisers adjusted comparable property sales prices for site size differences as small as 435 square feet or 4 percent ($10,000 adjustment) of the 11,325 square feet subject property site size. However, other appraisers did not make adjustments for differences as large as 13,419 square feet, or 242 percent of the 5,538 square feet subject property site size.

Declining Market Conditions

LGY Service policies and procedures did not provide sufficient criteria on the percent of housing market declines in comparable properties' market area that would require an adjustment, or an explanation of the appraiser's decision not to make an adjustment. The policies and procedures also did not include specific criteria on the amount of elapsed time between the date the comparable property sold to the appraisal date that would require an adjustment or an explanation for no adjustment.

During the past several years, significant declines in U.S. housing markets have been widespread. According to the U.S. Federal Housing Finance Agency, during the 1-year period ending September 30, 2010, the average U.S. home value declined 3.2 percent. Forty (80 percent) of 50 states experienced declines in home values ranging from 0.5 to 9.8 percent. In addition, some metropolitan areas experienced even higher declines, such as Madeira, CA (11.7 percent); Bend, OR (13.7 percent); and Deltona, FL (15.7 percent). However, for the 47 sampled appraisals, which were completed during this period of declining housing markets, appraisers did not make declining market adjustments for 122 (87 percent) of 141 comparable properties. Of the 122 comparable property sales prices that were not adjusted, the elapsed time between comparable property sale dates and appraisal dates averaged 116 days and was as high as 278 days.

The risk is significantly higher in a declining housing market that contract appraisers may not appropriately adjust comparable property sales prices for declining market conditions. To address this risk, LGY Service needs to evaluate current policies and procedures and make revisions that include detailed criteria RLC staff can use to help ensure contract appraisers appropriately adjust comparable property sales prices.

Automated Appraisal Reviews Are Needed

To further improve liquidation appraisal oversight and ensure fair and reasonable property valuations, LGY Service needs to use a comprehensive automated appraisal quality control review tool. As we discussed comparable property selections, adjustments, and nonadjustments with RLC staff and management, they stated the RLC had insufficient staffing resources to thoroughly review the large volume of appraisals completed. During FY 2011, contract appraisers completed about 40,000 liquidation appraisals. An automated appraisal review tool will help improve LGY Service oversight while also addressing RLC concerns about insufficient staffing. Automated appraisal review software is readily available for purchase from several companies. The benefits of such a tool include:

1. Improving the quality of appraisers' performance and appraisal reports
2. Creating quality benchmarks and standardized metrics for appraisers and appraisals
3. Identifying systemic and individual appraiser quality deficiencies
4. Leveraging existing resources to perform more detailed oversight
5. Reducing the time to perform appraisal reviews

Using an automated appraisal review tool that incorporates improved policy and procedures (including specific criteria related to evaluating comparable property selections, adjustments, and nonadjustments) will further support LGY Service's quality control efforts and reduce program risks. To help address the oversight improvement areas discussed in this report, the automated appraisal review tool should be capable of two things. First, it needs to provide risk-based scoring of appraisals that enables LGY Service to perform enhanced analysis of targeted appraisals. Second, it needs to be capable of reviewing individual appraisals for:

- Compliance with LGY Service policies and procedures
- Selection of best comparable properties using most recent property sales in proximity to the subject property

- Verification of comparable property sales prices and property characteristics available in public records and proprietary systems such as multiple listing services
- Completeness, accuracy, and consistency
- Property overvaluation or deviation from neighborhood norms

LGY Service managers agreed that automated appraisal reviews will strengthen oversight and initiated the procurement of Appraisal Management System/Automated Valuation Model Services (AMS/AVMS). According to LGY Service officials, in December 2011, VA announced the pre-solicitation for AMS/AVMS. LGY Service anticipates awarding the contract by January 2013.

Effect of Insufficient Oversight

Cleveland and Phoenix RLC's insufficient oversight of appraisal reports, inadequate criteria for appraisal reviewers, and lack of an automated appraisal review tool increased risks of VA not paying a fair and reasonable price when acquiring foreclosed properties. The two RLCs did not identify 89 percent of the comparable property selections, adjustments, and nonadjustments found during our audit that could affect property valuations.

Conclusion

Property appraisals are an important aspect of the LGY Program mission to assist eligible veterans and surviving spouses in purchasing and retaining homes. Liquidation appraisals are an integral part of LGY Service's process in deciding whether to use taxpayer funds to procure foreclosed properties and the price to pay when acquiring properties. LGY Service needs to improve the effectiveness of liquidation appraisal oversight to help ensure fair and reasonable property valuations.

During FY 2011, VA spent approximately $1.4 billion to acquire almost 14,000 foreclosed properties and incurred losses of about $450 million when selling nearly 16,400 properties. Factors determining VA losses include the price VA pays to acquire foreclosed properties, which are based on liquidation appraisals, VA's selling price, property maintenance costs, and depreciation costs. Therefore, VA needs to take quick actions to improve the oversight of appraisals. By strengthening the oversight of liquidation appraisals LGY Service will increase the accountability and stewardship of funds used to acquire foreclosed properties and safeguard the integrity of VA's LGY Program.

Recommendations

1. We recommended the Under Secretary for Benefits revise Loan Guaranty Service policies and procedures to include more specific criteria for evaluating appraisal comparable property selections and sales price adjustments.

2. We recommended the Under Secretary for Benefits implement an automated appraisal review system to evaluate every liquidation appraisal.

Management Comments

The Under Secretary for Benefits concurred in part with our recommendations and did not agree with many of our conclusions. The Under Secretary did not concur with Recommendation 1 and stated VBA policies and procedures provide adequately specific guidance for appraisal reviewers. VBA believes additional criteria are not necessary as they would have a detrimental effect on the program and would infringe on the independence of contract appraisers. VBA asserted this infringement would cause appraisers to rightly refuse to perform work for VA, due to fears of violating Uniformed Standards of Professional Appraisal Practice. Despite non-concurring with the recommendation, VBA stated that implementation of AMS/AVMS should resolve further concern.

The Under Secretary concurred with Recommendation 2 and stated VBA is currently in the process of obtaining an AMS/AVMS, which LGY Service will use to help ensure appraisal compliance with designated rules. VBA expects to implement the AMS/AVMS in June 2013.

In addition to responding to these recommendations, the Under Secretary discussed other concerns with the report. VBA stated it was not statistically valid to extrapolate findings from 47 cases selected from two offices to almost 16,400 properties sold nationally in FY 2011. Additionally, VBA stated that VA's $450 million loss from the sale of the 16,400 properties was the difference between the liquidation appraisal amounts and the final net sales proceeds of all properties sold by VA. This difference included property depreciation, property taxes, marketing and management expenses, and property preservation expenses. VBA contended the $450 million figure was improperly devised, inflated, and misrepresentative of the program.

Another concern raised by VBA was that LGY Service's review of 8 of the 47 sampled appraisals did not support OIG's assessment of the appraisals. VBA stated the OIG's review of the appraisals included errors in assessing key facts. VBA also noted that LGY Service conveyed the findings of its review to the OIG, yet OIG did not modify the report. Consequently, VBA continues to dispute the findings that portray numerous cases as errors on the part of appraisers and LGY Service's oversight staff.

OIG Response

Considering VBA dedicates significant resources to perform appraisal oversight, its reluctance to strengthen criteria used to perform the oversight seems shortsighted. VBA's reasons for not agreeing with Recommendation 1 and other concerns about our report are unwarranted. The first recommendation applies to specific criteria RLC staff can use to evaluate appraisals not to guide contract appraisers in performing appraisals. As such, VBA implementation of this recommendation would not infringe on contract appraiser independence or cause them to violate Uniformed Standards of Professional Appraisal Practice. We agree contract appraisers must follow industry and statutory requirements and standards to maintain appraiser independence. However, to ensure sufficient oversight, LGY Service must have adequate criteria RLC staff can use to identify appraisals warranting further review. For example, RLC staff need more specific criteria or benchmarks to know how wide a range of comparable property sales prices warrant further review and the distance between comparable properties and the subject property that warrant further review.

RLC staff told us they considered LGY Service policies and procedures inadequate because they did not provide sufficient details to help them consistently evaluate appraisal valuations. We also noted the lack of specific criteria resulted in inconsistency between RLC staff and LGY Service Central Office staff with regard to agreeing with our conclusions on the sampled appraisals. RLC staff agreed 100 percent with our results while LGY Service central office staff did not.

Furthermore, by moving forward with Recommendation 2 to procure an automated appraisal review tool, LGY Service is essentially implementing the intent of Recommendation 1. The solicitation for the procurement of the appraisal review tool states that the tool must create quality benchmarks and standardized metrics for appraisals and leverage existing resources to perform exception-based oversight. LGY Service will need to establish specific criteria for the automated tool to identify exceptions.

VBA questions the validity of statistically extrapolating findings from the 47 sampled cases. Our audit found that RLC staff did not sufficiently review 35 of 47 sampled appraisals. Our report does not include any statistical extrapolations of this finding. However, our report does explain that losses on sales of acquired properties is a risk associated with inaccurate liquidation appraisals.

Specifically, one of the factors affecting VA losses is the difference between the amount VA pays to acquire a foreclosed property (based on a liquidation appraisal) and the amount VA receives when selling the property (based on a marketing appraisal). We agree other factors affect VA losses, such as property depreciation and property maintenance costs and revised the report's conclusion to recognize these factors. We believe VA's $370 million loss in FY 2010 and $450 million loss in FY 2011 are significant costs of the LGY Program, which should be transparent to stakeholders, including Congress and taxpayers.

VBA also stated our review of the appraisals contained errors in assessing key facts. However, we had provided case-specific information for the 35 appraisals that needed further review to VBA staff at the audited RLCs. We believe the RLC staff were the most qualified VBA subject matter experts. These staff were RLC supervisors or senior employees who had years of field experience and knowledge and familiarity with the real estate markets where the appraisals were performed. As such, we discussed each case with RLC staff at length using the complete appraisal file, other RLC information related to the appraisal, and property information obtained from databases and sources recommended by RLC staff. The RLC staff agreed with our conclusions for all 35 appraisals. Officials in LGY Service Central Office subsequently reviewed 8 of the 35 appraisals and conveyed to us their concerns associated with their review. After considering their concerns, we determined our results, which RLC subject matter experts confirmed, did not include any errors.

We consider VBA's planned actions acceptable, and we will follow up on their implementation. Appendix C contains the full text of the Under Secretary for Benefits' comments.

Finding 2 Further Actions Needed to Strengthen LGY Service's Risk Management Program

Although LGY Service had initiated a Risk Management Program, LGY Service needs to take further actions to fully implement it to strengthen risk management. During FY 2010, LGY Service did not analyze internal control test results, develop corrective action plans, and conduct ongoing monitoring. During FY 2011, LGY Service still had not completed some important risk management actions. This occurred because the managers' FYs 2010 and 2011 performance plans did not ensure accountability for accomplishing specific requirements of the Risk Management Program. As a result, risks affecting LGY Service's ability to achieve program goals and objectives had the potential to go undetected until significant problems develop.

Risk Management Program Not Fully Implemented

Through FY 2011, LGY Service had not fully implemented a comprehensive Risk Management Program. Our April 2009 report, *Audit of Veterans Benefits Administration's Loan Guaranty Program Risk Management* (Report No. 08-01987-118, April 28, 2009), recommended the Under Secretary for Benefits establish policies and procedures requiring LGY Service to implement a comprehensive Risk Management Program that includes mechanisms for identifying, analyzing, and managing risks.

In April 2010, a year after the recommendation, LGY Service issued a memorandum establishing LGY Service's Risk Management Program policies and procedures. The goal of LGY Service's Risk Management Program is to minimize risks by identifying and prioritizing potential risks and identifying and testing internal controls. To help ensure effectiveness in identifying and mitigating risks, the Risk Management Program requires LGY Service to produce an assessment report each year addressing the current state of the Risk Management Program. In addition, status reports are required for any remediation plans implemented to correct identified deficiencies. The April 2010 memorandum also indicates that the Chief, Oversight Unit, is responsible for implementing the Risk Management Program.

The Government Accountability Office's report, *Internal Control Management and Evaluation Tool* (Report No. GAO-01-108G, August 2001) emphasizes the importance of promptly resolving the findings of audits and other reviews. LGY Service did not promptly resolve our April 2009 finding that LGY Service needed a comprehensive Risk Management Program. Over 2 years after we recommended establishing policies and procedures for risk management and over a year after establishing a Risk Management Program, LGY Service had not implemented significant elements of the program, including the annual risk assessment report and status reports detailing remediation plans to correct deficiencies.

Table 1 shows the status of LGY Service's implementation for the major requirements of each Risk Management Program element according to the Assistant Director for Oversight.

Table 1

LGY Service Progress in Implementing Risk Management Program (FYs 2010–2011)

Element	Major Requirements	Implementation	
		FY 2010	FY 2011
1. Planning	Beginning of each fiscal year, Internal Control Management (ICM) team coordinates and adjusts the process.	4/8/2010	10/15/2010
2. Risk Assessment	*Risks identified, examined, and prioritized.*	*9/30/2010*	*6/30/2011*
3. Identify Key Controls	ICM team identifies controls (processes and procedures) needed to mitigate potential risks.	9/30/2010	7/15/2011
4. Identify Control Information	ICM team analyzes controls and considers factors that may increase the risk of control failures.	9/30/2010	7/15/2011
5. Testing of Controls	ICM tests controls for each LGY business line throughout the fiscal year.	9/30/2010	9/9/2011
6. Analysis	ICM team analyzes test results.	Not Completed	9/16/2011
7. Findings	ICM team works with each Assistant Director and Business Line manager to finalize analyses, findings, and recommendations.	Not Completed	9/16/2011
8. Corrective Action Plan	Business lines develop corrective action plans (CAP) to track and improve deficiencies.	Not Completed	Not Completed
9. Reporting	At the end of each fiscal year, risk matrixes and CAPs are incorporated into a report.	Not Completed	Not Completed
10. Ongoing Monitoring	Every quarter, report detailing status of CAPs is provided to LGY senior management.	Not Completed	Not Completed

Source: LGY Service, Assistant Director for Oversight

LGY Service only completed the first 5 of the 10 major Risk Management Program requirements during FY 2010. In addition, during FY 2011, LGY Service completed only 7 of the 10 risk management requirements.

According to LGY Service managers, they did not fully implement the Risk Management Program because during FYs 2010 and 2011, their focus was on two other priorities—Loan Systematic Technical Accuracy Review (LoanSTAR) and AMS/AVMS. LoanSTAR is a process for reviewing the actions of appraisers, lenders, servicers, and RLC staff to ensure compliance with applicable laws, regulations, policies, and procedures. The other initiative, which LGY Service had taken significant steps towards implementing, is the procurement of AMS/AVMS, a comprehensive automated appraisal quality control review tool intended to improve the quality and consistency of the appraisal review process and decrease risks to the LGY Program.

To maximize the effectiveness of these initiatives, LGY Service must fully implement the Risk Management Program promptly and incorporate the results in its design and execution. For example, during FY 2010, LGY Service had not completed the Risk Management Program elements of testing controls, analyzing the test results and implementing Corrective Action Plans (CAPs) to improve deficiencies. As a result, LoanSTAR and AMS/AVMS may not adequately address control deficiencies and specific risks to the LGY Program.

LGY Service's progress in implementing its Risk Management Program did not adhere to requirements of its policies and procedures and did not reflect the urgency and commitment needed, especially considering the significant risks associated with the Nation's housing crisis and record numbers of foreclosures and declines in property values. To ensure LGY Service mitigates these risks, LGY Service must implement all 10 interdependent elements of its Risk Management Program. The following discussion provides examples of specific Risk Management Program requirements not completed promptly by LGY Service.

Testing Controls

Controls are the policies, procedures, techniques, and mechanisms that help ensure LGY Service mitigates risks identified during risk assessments. They are essential for proper stewardship and accountability for VA resources and for achieving effective and efficient program results. LGY Service must regularly evaluate controls to ensure they are still appropriate and working as intended. LGY Service did not adhere to the following Risk Management Program policy and procedure requirements related to testing of controls during FYs 2010 or 2011.

> Testing will be conducted throughout the fiscal year, commencing upon completion of planning, risk assessment, identifying key controls, and identifying control information for each business line.

To adhere to the dual requirements of testing controls throughout the fiscal year yet also commencing testing upon completion of the first four elements of planning through identifying control information, LGY Service must complete the first four elements near the beginning of each fiscal year. However, LGY Service did not complete identifying control information for FY 2010 until September 2010, the final day of the fiscal year, and did not complete identifying control information for FY 2011 until July 2011.

Our audit results show that LGY Service testing of controls needs improvement. LGY Service's September 2010 risk assessment report identified over-inflated property values as a possible risk area. The report also noted that in April 2009, LGY Service added a control to VBA Manual 26-2, Chapter 6, to ensure that lender or RLC staff review all appraisals.

In addition, LGY Service did not complete testing of controls until September 2011, the last month of the fiscal year. LGY Service officials stated that they tested controls to ensure VA-guaranteed properties were properly valued and reviewers were completing quality reviews of liquidation appraisals. LGY Service officials also stated that these tests concluded that established controls ensured accurate VA-guaranteed property values.

However, our review of 47 sampled Cleveland and Phoenix RLC real estate liquidation appraisals, found LGY Service oversight controls did not adequately identify comparable property selections, adjustments, and nonadjustments needing further review. If LGY Service had adequately tested its control of reviewing comparable properties selections and sales prices adjustments in appraisal reports, the testing would have shown that LGY Service needed to improve controls to include more specific criteria. This control improvement would provide adequate assurance that contractor appraisals reflect fair and reasonable property valuations.

Corrective Action Plans

To ensure outcomes of LGY Service control testing result in timely improvement of identified deficiencies, the Internal Control Management (ICM) team must promptly communicate the deficiencies to the individual responsible for the function and to at least one level of management above that individual. LGY Service must report serious deficiencies and internal control problems to top VBA management. Once reported, LGY Service must take corrective action or make improvements within established timeframes to resolve the matters brought to management's attention promptly. LGY Service did not adhere to the following Risk Management Program requirements related to CAPs.

> In order to track and follow up on deficiencies that have been found, LGY business lines will develop a Corrective Action Plan. This plan will serve as a roadmap to correct and monitor deficiencies. The CAP will be used for ongoing status reports to LGY senior management.

During FYs 2010 and 2011, LGY Service did not develop any CAPs because as previously discussed, its testing of controls concluded no deficiencies needed correction. By not developing CAPs, LGY Service has been operating without its planned “roadmap” for correcting and monitoring deficiencies and has proceeded with the LoanStar and AMS/AVMS initiatives that are intended to help improve oversight controls. To improve the effectiveness of its Risk Management Program, LGY Service needs to include both LoanSTAR and AMS/AVMS as part of an overall corrective action plan to track and improve deficiencies.

Reporting and Monitoring

The results of risk assessment, control testing, and CAPs must be reported to the Deputy Under Secretary for Economic Opportunity, LGY Service management, and others. To be effective, the reports must be provided in a form and within a time frame that enables internal stakeholders to carry out their control and operational responsibilities. Monitoring is crucial to ensure LGY Service completes the actions necessary to correct or otherwise resolve identified deficiencies. Ongoing monitoring needs to occur during normal operations and includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties. LGY Service did not comply with the following Risk Management Program requirements related to reporting and monitoring.

> **Reporting—**At the end of the fiscal year, the resulting risk matrices, CAPs, and actions taken will be incorporated into a report. This report will be distributed to the Assistant Directors and Deputy Director for an initial review, after which the report will be submitted to the Director of LGY Service on an annual basis for final review and concurrence.
>
> **Monitoring—**The ICM team, with approval from the Director of LGY, will designate various levels of management that will monitor and report progress. This information will be gathered and used for status reports to the Director until the issues are resolved. The current status of the CAPs will be included in a report for review by the LGY senior management team every quarter.

During FYs 2010 and 2011, LGY Service had not completed any of the required quarterly reports or end of fiscal year reports. LGY Service’s untimely and incomplete implementation of the requirements of its Risk Management Program hindered its ability to identify, monitor, and manage potential LGY Program risks.

Accountability

LGY Service had not fully implemented the Risk Management Program because the FYs 2010 and 2011 managers’ performance plans did not ensure accountability for accomplishing specific requirements of the Risk Management Program. VA policy requires managers to ensure performance plans include the elements and standards that identify expected performance and to revise performance plans during appraisal periods due to changes in work assignments. The elements and standards must express performance threshold(s), requirement(s), or expectation(s) that staff must meet to be appraised at a particular level of performance. Performance standards may include factors such as quality, quantity, timeliness, and manner of performance. They may also include specific recurring and nonrecurring goals, program plans, and priority programs.

LGY Service established the Risk Management Program in April 2010. However, LGY Service managers did not revise the FY 2010 performance plan of the Chief, Oversight Unit, to include elements or standards related to the program as required. This lack of accountability during FY 2010 resulted in LGY Service completing only 5 of 10 major Risk Management Program requirements.

The FY 2011 performance plan added an element for risk management and included the following requirements for achieving the fully successful level.

> Ensures that the Loan Guaranty Risk Management Program is fully completed each year, including risk assessments, testing of controls, reporting, and recommendations for corrective action.

The requirements for achieving the fully successful level are broad and general and, besides requiring the program to be "fully completed each year," they do not express any other specific performance thresholds or expectations. The following examples highlight possible performance plan improvements LGY Service could make to better comply with VA policy, including quantitative and timeliness factors and to strengthen accountability.

- **Semi-Annual Interviews—**Including a specific requirement to conduct semi-annual interviews of the LGY Assistant Director and Business Line Managers will help ensure managers have regular opportunities to discuss current and potential risks related to fraud, waste, and abuse.
- **Recurring Specific Goals—**Establishing specific goals, such as testing a certain number of controls or correcting a certain number of deficiencies identified in CAPs, will help ensure continuous testing and improvement of controls.
- **Quarterly Status Reports—**Defining or adjusting expectations for every quarter would help ensure managers have continuous feedback and updates on actions taken to address identified risks.
- **End of Fiscal Year Reports—**Including the specific requirement to provide the Director of LGY a report at the end of the fiscal year, including risk matrices results, CAPs, and actions taken, will help ensure LGY Service management obtains an annual comprehensive assessment of LGY Service risk-mitigation efforts.

LGY Service's inadequate accountability for managers accomplishing specific Risk Management Program requirements increased the risks of LGY

Service not effectively achieving LGY Program goals and objectives. Considering the myriad of risks associated with the ongoing significant instability of the U.S. housing market, it is imperative that LGY Service improve the management of LGY Program risks.

Conclusion

Full implementation of its Risk Management Program will provide LGY Service with a systematic, organized, and structured analysis of operations. Although LGY Service had implemented the OIG's prior recommendation to establish policies and procedures for a comprehensive Risk Management Program, LGY Service needs to take further actions to fully implement the program and strengthen risk management. It is critical that LGY Service complete all elements of its Risk Management Program. Without a fully implemented Risk Management Program, threats to LGY Service's mission of improving veterans' ability to purchase and retain homes have the potential to go undetected until significant problems arise.

Recommendations

3. We recommended the Under Secretary for Benefits fully implement all defined elements of the Loan Guaranty Service Risk Management Program.

4. We recommended the Under Secretary for Benefits revise the performance plan of the appropriate Loan Guaranty Service manager to ensure accountability for accomplishment of specific Risk Management Program requirements.

Management Comments

The Under Secretary for Benefits concurred with the recommendations, but expressed concerns about our conclusions on LGY Service's implementation of its Risk Management Program. The Under Secretary stated VBA implemented all defined elements of the LGY Service Risk Management Program in FY 2011 and completed the risk management report in October 2011. In addition, the Under Secretary stated VBA had revised performance standards of the Assistant Director for Oversight and the Chief of Quality Assurance positions to require completion of the Risk Management Program to achieve the fully successful level. The Under Secretary requested closure of both recommendations.

OIG Response

We disagree with these assertions; LGY Service did not provide us sufficient documentation showing full implementation of its Risk Management Program. For example, LGY Service did not provide any of the corrective action plans or quarterly and end of fiscal year reports required by its Risk Management Program policies and procedures. If VBA completed a risk management report in October 2011, VBA would have prepared the report 18 months after our *Audit of Veterans Benefits Administration's Loan Guaranty Program Risk Management* (Report No. 08-01987-118, April 28, 2009) recommended implementation of a Risk Management Program. Considering the Nation was continuing to recover from housing crises during

2009–2011, VBA's pace at implementing its Risk Management Program did not reflect the urgency required.

In addition, LGY Service has not provided us copies of the revised performance standards for the Assistant Director for Oversight and the Chief of Quality Assurance positions. We will follow up on implementation of the corrective actions. Appendix C contains the full text of the Under Secretary for Benefits' comments.

Appendix A Background

LGY Program Mission

LGY Program's mission is to assist service members and veterans to purchase and retain real estate properties. A key component of this mission is to guarantee up to 50 percent of veteran loans obtained to purchase real estate properties. If a veteran defaults on a VA-guaranteed loan and the lender forecloses, Federal law requires VA to pay the guaranteed amount and determine if VA should acquire the property.

Liquidation Appraisals

Before acquiring a foreclosed property, VA must obtain a liquidation appraisal of the property. LGY Service assigns contract appraisers, selected on a rotational basis from a panel of appraisers, to perform liquidation appraisals to assess the fair market value of foreclosed properties. Liquidation appraisals with fair and reasonable valuations are a key control in limiting LGY Program losses. During FY 2011, VA sold 16,400 properties at a loss of nearly $450 million.

From FY 2007 through 2011, the number of liquidation appraisals completed by contract appraisers increased a dramatic 181 percent. During FY 2011, contract appraisers conducted almost 40,000 liquidation appraisals of real estate properties valued at just over $5 billion.

Table 2 shows the locations of the nine RLCs operated by LGY Service.

Table 2

Regional Loan Center Locations*	
1. Atlanta, GA	6. Phoenix, AZ
2. Cleveland, OH	7. Roanoke, VA
3. Denver, CO	8. St. Paul, MN
4. Houston, TX	9. St. Petersburg, FL
5. Manchester, NH	

Source: LGY Service

**VARO Honolulu has a functioning LGY operation that VBA does not consider an RLC.*

Regional Loan Centers

All nine RLCs are co-located with VA regional offices. RLC staff perform desk and field oversight reviews of liquidation appraisals.

RLC Desk Reviews

LGY Service policies and procedures require RLC staff to perform desk reviews of all liquidation appraisals where loan servicers have not been authorized to issue notification of values. RLC staff performed desk reviews of 23,224 (59 percent) of the total 39,658 liquidation appraisals completed during FY 2011. RLC desk reviews focus on ensuring appraisal reports comply with LGY Service policies and procedures. Desk reviews include evaluating appraisal reports for complete, appropriate, consistent, and logical appraiser methodologies and conclusions.

RLC Field Reviews

LGY Service policies and procedures require RLC staff to perform field reviews of 10 percent of each contract appraiser's total appraisals. Appraisals selected for field reviews include origination and liquidation appraisals and appraisals reviewed by RLC staff and servicer staff appraiser reviewers (SARs). In addition, RLC staff are generally required to perform field reviews of all liquidation appraisals where the appraisal date is within 24 months of the original loan closing date and the appraised value is at least 20 percent lower than the original appraised value. During FY 2011, RLC staff performed 1,328 field reviews of liquidation appraisals.

LGY Service policies and procedures require field reviews to include evaluating the appraiser's comparable property selections to determine if they represent the best indicator of value for the subject property. RLC field review requirements also include conducting physical observations of subject and comparable properties to ensure they match the photographs included in the appraisal report. During the physical observations, the RLC staff must confirm property characteristics such as location, age, condition, needed repairs, and any significant changes since the origination appraisal date. LGY Service policies and procedures also require RLC management to perform second level reviews of 5 percent of each RLC staff appraiser's field reviews completed each fiscal year.

Servicer Appraisal Reviews

VA has established the Servicer Appraisal Processing Program that authorizes loan servicers to request and review contract appraiser liquidation appraisals. VA approves and trains SARs to conduct desk and field reviews of liquidation appraisals and issue notification of values. SARs performed desk reviews of 16,434 (41 percent) of the total 39,658 liquidation appraisals completed during FY 2011. LGY Service policies and procedures require servicers to have a quality control program that ensures SARs or independent contract appraisers perform random field reviews of liquidation appraisals. The quality control program also must ensure another independent party, such as an internal audit division, performs monthly reviews of 5 percent of each SAR's desk reviews.

Appendix B Scope and Methodology

Scope

We conducted our audit work from January 2011 through July 2012. To evaluate the effectiveness of LGY Service oversight, the audit focused on 9,361 real estate liquidation appraisals of foreclosed properties completed by the Cleveland and Phoenix RLCs during FY 2010. The audit did not include reviewing origination appraisals, which contract appraisers perform before veterans purchase homes. To follow up on our April 2009 audit that found LGY Service risk management needed improvement, we focused on LGY Service risk management efforts from April 2009 through September 2011.

Methodology

To evaluate the effectiveness of LGY Service oversight, we reviewed applicable Federal laws and regulations, LGY Service and Nashville Monitoring Unit policies and procedures, and previous OIG and Government Accountability Office audits related to the LGY Program. We reviewed the statement of objectives and solicitation for the planned procurement of AMS/AVMS and interviewed LGY Service and Nashville Monitoring Unit managers and staff to gain an understanding of internal controls and ongoing initiatives.

From the nine RLCs, we selected the Cleveland RLC randomly and the Phoenix RLC because of high real estate foreclosure rates in the states within the Phoenix RLC's jurisdiction. During visits to these two RLCs, we reviewed local policies, procedures, and handbooks and interviewed managers and staff. We also selected and reviewed a statistical random sample of 47 liquidation appraisals from the Cleveland RLC (24 appraisals) and the Phoenix RLC (23 appraisals).

The 47 statistically sampled appraisals were representative of the 9,361 total liquidation appraisals completed by the Cleveland and Phoenix RLCs during FY 2010. These 9,361 appraisals were 23 percent of the 40,018 total LGY Service liquidation appraisals completed during FY 2010. For each of the 47 sampled appraisals, we evaluated the electronic liquidation appraisal records from VBA's WebLGY, which is a secure Web-based repository that includes LGY Program real estate appraisal data.

Our review of sampled appraisals included evaluating adherence with LGY Service and RLC policies and procedures. It also involved comparing subject and comparable property information shown on the appraisal with information reported in county property tax records and national real estate databases. The comparable property selections we identified were instances where a national real estate database reported a different property sale that met at least two of the three main factors (narrow sales price range for three comparable properties, sales date typically within 6 months of subject property appraisal date, and close proximity to subject property) better than the property selected by the appraiser.

The adjustments we identified were instances where a national real estate database or county property record indicated that an appraisal report adjustment for a comparable property characteristic should have been a higher or lower dollar amount. The nonadjustments we identified were instances where the appraisal report did not include any dollar adjustment for a significant comparable property characteristic difference from the subject property.

We discussed comparison property selection, adjustment, and nonadjustments that needed further review with RLC managers and staff, who concurred with our results. We did not determine the potential effect on property valuations. During visits to the Cleveland and Phoenix RLCs, we also evaluated RLC appraisal oversight and appraiser qualifications and rotations.

To follow up on our April 2009 audit that found LGY Service needed to improve risk management, we reviewed LGY Service risk management policies and procedures, risk assessments, and the performance plans of LGY Service managers. We also interviewed LGY Service and Oversight Unit managers and staff to gain an understanding of risk management controls.

Data Reliability

We used computer-processed data obtained from WebLGY. To determine the reliability of this data, we compared selected data elements (such as appraisal request and completion dates, appraiser names and license numbers, and appraised property values) with scanned hard-copy appraisals. We concluded that the computer-processed data used to accomplish the objectives were sufficiently reliable.

Government Audit Standards

Our assessment of internal controls focused on those controls relating to our audit objectives. We conducted this performance audit in accordance with generally accepted government auditing standards. These 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.

Appendix C Additional Examples of Liquidation Appraisals Needing Further Review

As discussed in the body of the report, for 35 of 47 sampled Cleveland and Phoenix RLC liquidation appraisals, RLC staff needed to conduct further reviews of adjustments or nonadjustments related to comparable property sales prices. The report includes examples of adjustments or nonadjustments related to room counts and gross living areas. This appendix includes additional examples related to site size, declining market conditions, property conditions, fireplaces, and other miscellaneous adjustments and nonadjustments.

Site Size

Eight liquidation appraisals had a total of 11 adjustments or nonadjustments related to property site size differences RLC staff needed to review further. LGY Service policies and procedures require appraisal reports to include site size in terms of acreage or square footage for the subject and comparable properties. The site size adjustments and nonadjustments related to subject and comparable property site size differences ranging from 361 to 13,419 square feet. The following example highlights a nonadjustment for a property site size inconsistency RLC staff should have reviewed further to help ensure VA paid a fair and reasonable price for the property.

> In February 2010, a contract appraiser valued a subject property located in Ohio at $122,000. The appraisal report included a subject property site size inconsistency that was not identified by RLC staff. In one section, the appraisal report showed subject property dimensions of 39 feet by 142 feet, which is equivalent to an area of 5,538 square feet. However, another section showed the subject property area as 11,151 square feet. The report showed 18,957 square feet for one of the comparable properties, which was 41 percent more than the 11,151 square feet and 242 percent more than the 5,538 square feet. However, the appraisal report showed no adjustment to the comparable property's sales price for the significant square footage difference.

Declining Market Conditions

Seven appraisals had a total of 14 nonadjustments to comparable property sale prices for declining market conditions. LGY Service policies and procedures require appraisal reports to complete a Market Conditions Addendum to provide a clear and accurate understanding of market conditions prevalent in the subject property's neighborhood. The appraiser must use the addendum as the basis for housing trends and overall market condition conclusions. LGY Service policies and procedures also require appraisal reports to include comparable property sales dates and adjustments to comparable properties' sale prices to account for significant property value appreciation or depreciation in the geographical area. Typically, appraisers base these adjustments on the number of days between the comparable properties' sale dates and the subject property's appraisal date. The following example highlights a nonadjustment for declining market conditions.

> A contract appraiser valued a subject property located in Ohio at $49,000. The appraisal report showed that the subject property was located in a neighborhood with a declining housing market trend. The report also noted that the area has been harder hit by the real estate slowdown than other areas of the county. One of the comparable properties had sold about 11 months earlier. However, the appraiser did not adjust the comparable property's sales price to account for the declining market.

Property Conditions

Two appraisals had a total of three nonadjustments to comparable property sale prices for property condition differences. For the subject property and each comparable property, LGY Service policies and procedures require appraisers to show the property's condition using terms such as poor, fair, average, good, or excellent. LGY Service policies and procedures also require appraisers to include a description of the subject property condition, needed repairs, and deterioration. The following example highlights a nonadjustment for property conditions.

> A contract appraiser valued a subject property located in New Mexico at $155,000. The appraisal report showed the subject and all three comparable properties' condition as average. The report also included a rear photograph of the subject property showing stucco breakage and missing shingles from patio roofing. The appraisal description and photos of the comparable properties indicated no disrepair, which indicates that the comparable properties were in better condition than the subject property. However, the report did not show an adjustment for these condition differences in comparable properties' sale prices.

Fireplaces

Two appraisals had a total of five adjustments or nonadjustments related to fireplace differences RLC staff needed to review further (two adjustments and three nonadjustments). LGY Service policies and procedures require appraisers to show the number of fireplaces for subject and comparable properties. The following example highlights a nonadjustment for a fireplace.

> A contract appraiser valued a subject property located in Indiana at $28,000. The appraisal report showed the subject and three comparable properties did not have fireplaces. However, the report also included a photograph of the subject property interior that clearly showed a fireplace. In addition, a national real estate database reported the subject property had a fireplace. The report did not adjust the comparable properties' sales prices for the fireplace differences.

Miscellaneous Adjustments or Nonadjustments

Four appraisals had a total of six adjustments or nonadjustments related to miscellaneous property characteristic differences RLC staff needed to review further. These characteristics included landscaping, swimming pools, and proximity to railroad tracks. LGY Service policies and procedures require appraisal reports to include other property characteristics where differences between subject and comparable properties may affect appraised values. The following example highlights a miscellaneous nonadjustment related to swimming pool and landscaping differences.

A contract appraiser valued a subject property located in California at \$75,000. The appraisal report showed the subject property did not have a swimming pool while one of the comparable properties had a swimming pool and spa. The appraisal also noted that the appraiser did not adjust the comparable property's sales price because the listing agent reported the swimming pool and spa needed "TLC." However, as highlighted in Figure 2, aerial photographs clearly show the comparable property had a swimming pool, extensive trees, and shrubbery landscaping while the subject property did not.

Figure 2

Property Swimming Pool and Landscaping Differences

Comparable Property **Subject Property**

Source: Google Maps

Appendix D Under Secretary for Benefits Comments

Department of Veterans Affairs

Memorandum

Date: September 7, 2012

From: Under Secretary for Benefits (20)

Subj: OIG Draft Report—Audit of Liquidation Appraisal Oversight, Cleveland and Phoenix Regional Loan Centers [Project No. 2010-04045-R3-0360]—VAIQ 7191513

To: Assistant Inspector General for Audits and Evaluations (52)

1. Attached is VBA's response to the OIG draft report: Audit of Liquidation Appraisal Oversight, Cleveland and Phoenix Regional Loan Centers. Based on the information in the current draft report, VBA has significant concerns with the report as written, and does not agree with many of the conclusions reached by OIG. We have held several meetings aimed at resolving areas of disagreement. While OIG has made changes to earlier draft reports, it is my understanding that OIG declines to make additional changes or have further discussion.

2. As such, VBA concurs in part with OIG's draft report. While we concur with recommendation 2 to implement an Automated Valuation Model/Appraisal Management System, and with recommendations 3 and 4 regarding risk management, we do not concur with recommendation 1, which states that VBA should provide more specific criteria for evaluation of comparable properties and sales price adjustments.

3. VBA's major concerns with the report are expressed below :

   - OIG repeatedly states that Loan Guaranty Service (LGY) policies and procedures, which guide LGY's review of appraisals and comparable properties, are not sufficiently specific. OIG's recommendation that LGY should prescribe additional specific requirements for appraiser selection and adjustment to comparable properties and for LGY appraisal review staff evaluation of appraisals is unnecessary, as specific requirements are already in place. To add additional requirements would have a detrimental effect on the program. VA's policies and procedures guiding appraisers and appraisal reviewers reflect industry and statutory requirements and standards, and are sufficient to ensure proper valuations. Additional requirements would impinge upon the independence of appraisers and could cause appraisers to refuse to perform work for VA, due to fears of violating the Uniformed Standards of Professional Appraisal Practice.

- OIG states that VA must improve the oversight of appraisals, due to a loss of approximately $450 million on the sale of nearly 16,400 properties in FY 2011. VBA notes first that it is not statistically valid to extrapolate findings from the 47 cases selected from two offices to the almost 16,400 properties sold nationally in FY 2011. Secondly, the $450 million is the difference between the liquidation appraisal amounts and the final net sales proceeds of all properties sold by VA. The liquidation appraisal occurs prior to foreclosure, on average 8 months prior to the actual sale of the property by VA. During those eight months, properties depreciate (in record amounts during the past four years), and VA pays property taxes, marketing and management expenses, property preservation expenses, capital improvements, as well as repairs. Therefore, the figure reported is improperly devised, inflated, and misrepresentative of the program.

- LGY made numerous requests for the details on the appraisals that OIG's audit deemed "required additional review." OIG provided detailed case information on only 8 of the 47 appraisals OIG reviewed. LGY's own review of those 8 cases did not support OIG's assessment of the appraisals. For example, LGY found in some instances, OIG's review of the appraisals contained errors in assessing key facts, such as a property's reported square footage. Despite OIG's assertions to the contrary, LGY also found in other cases that appraisers did act appropriately in selecting comparable properties, and in some cases offered double the average number of comparable properties, making appropriate sales price adjustments and documenting their rationale for such activities. LGY conveyed the findings of its review to OIG, yet OIG did not modify the report. Consequently, VBA continues to dispute the findings which portray numerous cases as errors on the part of appraisers and LGY's oversight staff.

- OIG states in the report that LGY did not develop risk management policies and procedures timely and that key elements of the risk management program were not fully implemented in a timely manner. In response to an April 2009 OIG audit, LGY established a corrective action plan, which established risk management policies and procedures by March 2010. Between April 2009 and March 2010, VBA continually reported to OIG on the progress in establishing the corrective action plan, and communicated the policies and procedures to LGY staff in April 2010.

4. Questions may be referred to Nancy Holly, Program Analyst, at 461-9199.

Allison A. Hickey

Attachment

Veterans Benefits Administration (VBA)
Comments on OIG Draft Report
Audit of Liquidation Appraisal Oversight, Cleveland and
Phoenix Regional Loan Centers

The Veterans Benefits Administration provides the following comments in response to the recommendations in the OIG Draft Report:

Recommendation 1: We recommend that the Under Secretary for Benefits revise Loan Guaranty Service policies and procedures to include more specific criteria for evaluating appraisal comparable property selections and sales price adjustments.

VBA Response: Non-Concur. VBA Manual 26-2, Chapter 6, provides adequately specific guidance for VA staff reviewers regarding evaluation of comparable property selections and sales price adjustments. This document directs VA staff reviewers to evaluate certain criteria presented in an appraisal report that would represent a 'red flag' and to question the fee appraiser's use of those criteria. Additionally, the policies and procedures in the VA Lender's Handbook, Chapter 11, Section 7, *Selection and Analysis of Comparables*, includes specific criteria for appraiser selection of comparables, and for sales price adjustments based on those comparables. These policies and procedures are reflective of the industry standard, the Uniformed Standards of Professional Appraisal Practice (USPAP). Consequently, it is not necessary for LGY to provide additional criteria, as they would have a detrimental effect on the program. VA's policies and procedures guiding appraisers and appraisal reviewers reflect industry and statutory requirements and standards, and are sufficient to ensure proper valuations. Should LGY independently establish additional criteria, this would infringe on the independence of contract appraisers. This infringement would cause appraisers to rightly refuse to perform work for VA, due to fears of violating USPAP. VA will continue to review appraisals for adherence to the USPAP and current VA standards. Implementation of the Automated Valuation Model/Appraisal Management System (in FY 2013) should resolve further concern.

Recommendation 2: We recommend that the Under Secretary for Benefits implement an automated appraisal review system to evaluate every liquidation appraisal.

VBA Response: Concur. VBA is currently in the process of obtaining an Automated Valuation Model/Appraisal Management System (AVM/AMS), which will be used primarily as a metric-based evaluation tool for exception-based oversight to maintain consistency and to ensure appraisal compliance with designated rules. AVM/AMS will be used in conjunction with current risk-mitigation methodologies that include field and desk reviews to ensure VA has a complete and thorough risk assessment of its valuation program. VBA expects to implement the AVM/AMS in June 2013.

Target Completion Date: June 30, 2013

Recommendation 3: We recommend that the Under Secretary for Benefits fully implement all defined elements of the Loan Guaranty Service Risk Management Program.

VBA Response: Concur. VBA implemented all defined elements of the Loan Guaranty Service risk management program in FY 2011 and VBA completed the risk management report in October 2011.

VBA requests closure of this recommendation.

Recommendation 4: We recommend that the Under Secretary for Benefits revise the performance plan of the appropriate Loan Guaranty Service manager to ensure accountability for accomplishment of specific Risk Management Program requirements.

VBA Response: Concur. Although VBA's original risk management performance standards included criteria to assess accomplishment of the program requirements, VBA further revised the performance standards of the Assistant Director for Oversight and the Chief of Quality Assurance positions with more detailed language. Specifically, in February 2012, the performance plan requirements to achieve the fully successful level were revised to include the following verbiage:

"Conducts semi-annual interviews with the Loan Guaranty Assistant Directors and business line managers to discuss current and potential risks related to fraud, waste, and abuse. Provides quarterly status reports to managers and Loan Guaranty leadership on actions taken to address identified risks. Ensures that the Loan Guaranty Risk Management program is fully completed each fiscal year, and provides the Loan Guaranty Director a report that includes risk assessments, testing of controls, reporting, risk matrices, results, recommendations for corrective action plans, and risk mitigation efforts."

VBA requests closure of this recommendation.

Appendix E Office of Inspector General Contact and Staff Acknowledgments

OIG Contact	For more information about this report, please contact the Office of Inspector General at (202) 461-4720.
Acknowledgments	Kent Wrathall, Director Marilyn Barak George Boyer Stacey Gavalas Lee Giesbrecht Nathaniel Holman Earl Key Whittie Lockett Jamillah Mallory Cheri Preston Leon Roberts Wilfredo Romero

Appendix F Report Distribution

VA Distribution

Office of the Secretary
Veterans Health Administration
Veterans Benefits Administration
National Cemetery Administration
Assistant Secretaries
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Non-VA Distribution

House Committee on Veterans' Affairs
House Appropriations Subcommittee on Military Construction, Veterans Affairs, and Related Agencies
House Committee on Oversight and Government Reform
Senate Committee on Veterans' Affairs
Senate Appropriations Subcommittee on Military Construction, Veterans Affairs, and Related Agencies
Senate Committee on Homeland Security and Governmental Affairs
National Veterans Service Organizations
Government Accountability Office
Office of Management and Budget

This report will be available in the near future on the OIG's Web site at http://www.va.gov/oig/publications/reports-list.asp. This report will remain on the OIG Web site for at least 2 fiscal years.