



DEPARTMENT OF THE TREASURY  
WASHINGTON

December 22, 2008

INSPECTOR GENERAL

The Honorable Charles Grassley  
Ranking Member  
Committee on Finance  
United States Senate  
Dirksen Senate Office Building, SD-219  
Washington, D.C. 20510-6075

Dear Mr. Grassley:

On July 11, 2008, the Office of Thrift Supervision (OTS) closed IndyMac Bank and appointed the Federal Deposit Insurance Corporation (FDIC) receiver. FDIC estimated the loss to the Deposit Insurance Fund for the failed bank at \$8.9 billion. As required by law, my office began performing a material loss review of IndyMac to determine the cause(s) of the thrift's failure and assess OTS's supervision over the institution. That review is ongoing. As is common with the failure of a publicly-held insured financial institution, other Federal agencies including the Securities and Exchange Commission (SEC) and FDIC also conduct reviews. In the case of IndyMac, SEC reviewed workpapers prepared by IndyMac's auditor, Ernst & Young (E&Y). One such workpaper reported a telephone discussion involving IndyMac's Chief Executive Officer (CEO), E&Y auditors, and OTS's West Region Director, Darrell Dochow, regarding an infusion of capital to IndyMac from its holding company, backdated to the first quarter of 2008. Because of its potential relevance to our material loss review, FDIC's Inspector General in turn provided the E&Y workpaper to our office.

At Secretary Paulson's request, I initiated an inquiry into the matter and am providing you with a status of what we have learned. Specifically, I am addressing whether:

- the Director of Office of Thrift Supervision's (OTS) West Region approved a capital infusion received by IndyMac Bank, F.S.B. (IndyMac), from its holding company after March 31, 2008, to be recorded as capital of the thrift as of March 31, 2008, and
- if so, the effect of recording the transaction in this manner.

The E&Y workpaper referred to review differences (proposed adjustments)<sup>1</sup> identified by the auditor during its review of IndyMac's interim financial statements for the quarter ending March 31, 2008. It also referred to proposed adjustments identified by E&Y during its audit of IndyMac's calendar year 2007 financial statements. Had the proposed adjustments identified by

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<sup>1</sup> It is not unusual for an auditor to propose adjustments. It is also not unusual for management to waive the recordation of those adjustments. In practice, the auditor keeps track of the total effect of any unrecorded adjustments and if that total effect becomes material to users, the auditor will insist that the adjustments be recorded. Failure to do so by management will result in a modification of the auditor's opinion.

the auditor during its 2007 audit and 2008 review been recorded, IndyMac's capital ratio as of March 31, 2008, would have fallen below the 10 percent "well-capitalized" minimum threshold.<sup>2</sup>

According to the workpaper, on May 9, 2008, E&Y participated in a conference call with OTS West Region Director Dochow and IndyMac's CEO, Michael Perry. During the call, CEO Perry asked if OTS would allow IndyMac to record an April 2008 capital contribution from IndyMac's holding company to IndyMac Bank as of March 31, 2008. If so, that would enable IndyMac to meet the "well capitalized" threshold as of March 31, 2008. The workpaper indicated that West Region Director Dochow acknowledged the issue of the review differences and agreed to IndyMac's proposal. As a result, IndyMac's total risk-based capital ratio was restored back over the 10 percent "well-capitalized" minimum threshold for the March 31 report.

We confirmed through inquiry and review of additional supporting documentation that the circumstances occurred essentially as represented in the E&Y workpaper. The one exception is that the capital contribution in question occurred on May 9, 2008, not in April 2008 (nearly 6 weeks after the end of the quarter and the day of the conference call between E&Y, West Region Director Dochow, and IndyMac CEO Perry). The circumstances and accounting of this transaction as described by OTS are unclear and the documentation provided by OTS was ambiguous and incomplete. For example, OTS provided information indicating that the IndyMac holding company made a \$50 million capital contribution on May 9, 2008, of which \$18 million (the amount necessary for IndyMac to be "well capitalized") was recorded by the thrift as capital as of March 31, 2008. OTS also stated that IndyMac had recorded this amount as a receivable at March 31, 2008. OTS, however, did not provide documentation showing the recordation of the receivable. Furthermore, based on other documentation we obtained, the capital contribution of \$50 million was intended by the holding company's board of directors to be for the second quarter (quarter ending June 30, 2008).

The impact of West Region Director Dochow's approval to record the capital infusion in the quarter ending March 31, 2008, was that IndyMac was able to maintain its "well-capitalized" status, and avoid the requirement in law to obtain a waiver from FDIC to accept brokered deposits.<sup>3</sup> It also solved another problem in that E&Y indicated that without IndyMac's acceptance of several proposed adjustments relating to the bank's capitalization, it would not have signed the interim review. IndyMac needed the signed interim review in order to file a complete quarterly report (10Q), as required, with the SEC on May 15, 2008.

During our inquiry, we also discovered that OTS had allowed other thrifts to record capital contributions in an earlier period than received. While there is some support in authoritative accounting literature for recording capital contributions in one period that were received in a

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<sup>2</sup> When an institution falls below "well-capitalized," certain restrictions automatically take affect.

<sup>3</sup> There are five established capital classifications for insured financial institutions: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. The use of brokered deposits is limited to well-capitalized insured depository institutions. Adequately capitalized institutions are required to obtain a waiver from FDIC in order to accept brokered deposits.

later period,<sup>4</sup> that support is limited.<sup>5</sup> Basically, IndyMac could record the capital infusion as of the quarter ending March 31, 2008, provided there was an actual note, a board resolution, or some form of communication showing the intent of the holding company at the time to infuse the capital (we also would expect that the holding company would have the capital available at March 31). However, in our work thus far, we have neither found nor been shown any indication that this intent existed. It is unclear what information OTS had at the time and what its basis was for allowing the capital infusion to be recorded for the quarter ending March 31, 2008. A separate inquiry as to a motive for approving and recording this transaction in the manner it was recorded is still ongoing. We are also continuing to obtain additional documentation to assess the accounting treatment of the capital contribution as of March 31, 2008. Our findings in that regard will also be discussed in the separate audit report.

An identical letter has been sent to the Honorable Max Baucus, Chairman. Should you or your staff have any questions, you may contact me at (202) 622-1090 or Marla A. Freedman, Assistant Inspector General for Audit, at (202) 927-5400.

Sincerely,

A handwritten signature in black ink, appearing to read 'Eric M. Thorson', with a long horizontal flourish extending to the right.

Eric M. Thorson  
Inspector General

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<sup>4</sup> Financial Accounting Standards Board (FASB) Evolving Issues Task Force Abstract 85-1, *Classifying Notes Received for Capital Stock* (Abstract 85-1).

<sup>5</sup> In recent discussions with a FASB staff representative regarding Abstract 85-1 and the applicability of it to these circumstances, the reporting of a note as an asset is generally not appropriate, except in very limited circumstances and when there is substantial evidence of the ability and intent to pay within a reasonably short period of time.