AUDIT OF THE NORTHEAST SERVICE CENTER'S SUBSIDIARIES INVENTORY

Audit Report No. 00-003
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OFFICE OF AUDITS

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FDIC
Federal Deposit Insurance Corporation
1201 W. Peachtree St., NE, Suite 1800
Atlanta, Georgia 30309

Office of Audits
Office of Inspector General

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TO: Jon R. Karlson, Regional Director
Division of Resolutions and Receiverships
Northeast Service Center

FROM: Carl S. Mays
Regional Director

SUBJECT: *Audit of the Northeast Service Center's Subsidiaries Inventory* (Audit Report No. 00-003)

This report presents the results of the Office of Inspector General's (OIG) audit of the Northeast Service Center's (NESC) subsidiaries inventory. The audit addressed whether the NESC accounted for all subsidiaries owned by failed institutions in its geographic area of responsibility. The NESC's subsidiaries inventory consisted of subsidiaries of failed institutions as well as partnerships and joint ventures in which those subsidiaries had an ownership interest. We did not consider partnerships and joint ventures owned directly by the failed institutions to be part of the NESC's subsidiaries inventory.

We performed the audit because the NESC's workload was scheduled to be transferred to the Dallas Office by June 30, 2000, which compounded the need for an accurate subsidiaries inventory because of the institutional knowledge loss when the NESC closes. A system of record should include all items that it is designed to track. A complete inventory of subsidiaries is needed to ensure the proper management and disposition of each subsidiary, which includes identifying the status of each subsidiary, performing asset searches to identify all assets owned, identifying management goals, upstreaming[1] discovered assets, and preparing annual and final tax returns, among other things.

BACKGROUND

The Federal Deposit Insurance Corporation (FDIC) and the Resolution Trust Corporation (RTC)[2] assumed control of the management and disposition of the assets of failed financial institutions. In many cases, those failed financial institutions owned subsidiaries that provided diverse business

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[1]Upstreaming is used to describe the posting of assets belonging to a dissolved subsidiary to the books of the subsidiary's parent failed financial institution receivership.

[2]As provided in the *RTC Completion Act of 1993*, the RTC went out of existence on December 31, 1995, and the FDIC took over its functions on January 1, 1996.

services such as mortgage lending and servicing, real-estate development and sales, insurance, credit cards, travel, and security sales and underwriting. Subsidiaries maintained their financial records separately from the parent institutions financial records, and financial institutions recorded the subsidiaries in their financial statements as investments. Accordingly, subsidiaries' assets did not appear on the parent institutions' financial records. Subsidiaries' assets included not only assets owned directly by subsidiaries—such as real estate, cash, stocks, bonds, and mortgages—but also ownership in partnerships and joint ventures.

Subsidiaries were usually incorporated in states where they conducted business and were required to file annual reports showing business activity and pay annual incorporation fees as long as they existed as ongoing entities. Requirements for dissolution varied from state to state. Typically, if a subsidiary did not file an annual report or pay required fees, the cognizant state could involuntarily dissolve the subsidiary until reporting requirements were met. When a subsidiary ceased business activity, it could file a formal request for dissolution with the state where it was incorporated. Some states require subsidiaries to dispose of all assets and liabilities and have zeroed balance sheets before dissolution, while other states do not have those requirements.

The RTC maintained its inventory of subsidiaries on the Subsidiary Information Management Network (SIMAN), which became the FDIC's system of record for subsidiaries when the FDIC and RTC merged. Before the merger, the FDIC did not maintain a separate system of record for subsidiaries.

The FDIC closed its offices at South Brunswick, New Jersey; Westborough, Massachusetts; and Franklin, Massachusetts; and the RTC closed its office at Valley Forge, Pennsylvania. In addition to their own staff, those offices hired contractors to manage and sell subsidiaries. The NESC assumed responsibility for managing the remaining assets, including subsidiaries, from those offices. During our audit, the NESC completed an effort called the "SIMAN Project" to establish the universe of all FDIC subsidiaries for its geographic area of responsibility. The NESC added 302 subsidiaries to the SIMAN system because of that project.

OBJECTIVE, SCOPE, AND METHODOLOGY

The audit objective was to determine whether the NESC had a complete inventory of subsidiaries belonging to failed financial institution receiverships in its geographic area of responsibility. To accomplish the objective, we interviewed personnel from the NESC's Subsidiary Department; the Legal Division; and the Division of Finance (DOF), Dallas Field Finance Center. We reviewed the Division of Resolutions and Receiverships' (DRR) records from the consolidations of the FDIC offices at South Brunswick, New Jersey; Westborough, Massachusetts; and Franklin, Massachusetts; and the merger of the RTC office at Valley Forge, Pennsylvania, into the NESC. We also reviewed subsidiaries' records from FDIC and RTC contractors.

We determined that DRR, DOF, and the Legal Division maintained their own inventories of subsidiaries to meet their individual needs. Table 1 shows the purpose of each division's inventory and the number of subsidiaries under the NESC's jurisdiction on each inventory.

Table 1: NESC Subsidiaries Inventory Lists

Maintained By	As of Date	Number of Subsidiaries	Purpose of Inventory
DRR	02/25/99	1,636	Management/dissolution of subsidiaries
DOF	04/30/94	940[a]	Financials/tax returns for subsidiaries
Legal Division	04/20/99	878	Litigation involving subsidiaries/dissolution

[a]DOF's inventory contained 1,015 subsidiaries; however, we eliminated 75 subsidiaries that were either duplicates or dissolved prior to the parent institutions' failure dates.

Source: OIG analysis of DRR's, DOF's, and the Legal Division's subsidiaries inventories.

We merged the three inventories to obtain a consolidated list of 2,294 unduplicated subsidiaries that became the basis for our analysis. To verify information contained in the DRR, DOF, and Legal Division inventories, we reviewed the closing books of failed FDIC and RTC institutions. We reviewed records related to subsidiaries for 21 of the 157 FDIC institutions and 37 of the 97 RTC institutions under the NESC's jurisdiction. Lists of the FDIC and RTC institutions we reviewed were provided to your staff on September 2, 1999. We judgmentally selected those 58 financial institutions based on the number and size of subsidiaries listed for each institution and the location of the majority of each institution's records. Because the closing books did not always provide a complete inventory of the failed institutions' subsidiaries, we searched the FDIC's Records Management Asset Tracking System for each failed financial institution in our sample to identify additional subsidiaries. From that search, we obtained and reviewed dozens of boxes of failed institution and corporate records stored at Iron Mountain and Pierce Leahy records storage facilities. Specifically, we reviewed records dated before or near each institution's failure date to determine which subsidiaries were active at the time each financial institution failed.

To identify assets of subsidiaries that were not in SIMAN, we recorded assets or business activities that we found during our review of subsidiaries' records. We also used the assets library and corporate information files from LEXIS/NEXIS[3] and various Internet databases to research the ownership of real estate and incorporation status of various subsidiaries. We obtained state incorporation status reports for 293 of the 429 subsidiaries (363 corporations plus 66 partnerships) identified by our review, which were not included in SIMAN. A search of the LEXIS/NEXIS system verified by name and state only 293 of the 363 subsidiaries that were corporations.[4] The 66 partnerships identified as subsidiaries were not incorporated and, therefore, not required to submit annual filings to the states. Accordingly, we did not research those partnerships through LEXIS/NEXIS.

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[3]LEXIS is a full text legal services database that includes federal and state statutory, regulatory, and case law materials. NEXIS includes a large number of national and local business journals, wire services, and newspapers, including extensive back files, NAARS (a tax accounting database), and public record databases.

[4]We did not verify the information provided by LEXIS/NEXIS to state records.

We also searched the unclaimed property databases on the Internet for the states of Florida, New York, and Rhode Island to identify any unclaimed assets belonging to subsidiaries. In addition, we visited county and city offices in Massachusetts to verify the disposition or other resolution of identified assets.

We did not evaluate the NESC's system of internal controls over its subsidiaries inventory because the OIG concluded that the audit objective could be met more efficiently by conducting substantive tests rather than placing reliance on the internal control system. The OIG conducted the audit from December 1998 to August 1999 in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

The NESC did not have a complete inventory of all FDIC subsidiaries for its geographic area of responsibility. Specifically, the OIG and NESC identified 731 subsidiaries after we commenced the audit, which were not included in SIMAN, the FDIC's system of record for subsidiaries. A system of record should include all items that it is designed to track. A complete inventory of subsidiaries is needed to ensure the proper management and disposition of each subsidiary, which includes identifying the status of each subsidiary, performing asset searches to identify all assets owned, identifying management goals, upstreaming[5] discovered assets, and preparing annual and final tax returns, among other things. Furthermore, we could not determine whether the NESC always performed asset searches before dissolving subsidiaries. We believe that, in addition to maintaining a complete subsidiaries inventory, the NESC should also perform searches for subsidiaries' assets because the FDIC does not record individual assets of subsidiaries in receivership books. With our limited asset search, we identified assets belonging to dissolved, sold, and active subsidiaries that were not accounted for in subsidiary books or upstreamed to the receivership.

NESC's Subsidiaries Inventory Was Not Complete

The NESC's inventory of FDIC subsidiaries was not complete.[6] Specifically, after we commenced our audit, 731 additional subsidiaries were identified that were not included in SIMAN. Of the 731 additional subsidiaries, the NESC identified and added 302 subsidiaries to SIMAN as part of an effort called the SIMAN Project that was completed during our audit. NESC officials also identified 160 other subsidiaries but did not add them to SIMAN because they could not locate necessary information such as tax identification numbers. However, we located much of the required data needed to add the 160 additional subsidiaries to SIMAN, which we provided to the NESC on April 29, 1999.

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[5]Upstreaming is used to describe the posting of assets belonging to a dissolved subsidiary to the books of the subsidiary's parent failed financial institution receivership.

[6]We found no discrepancies relating to the inventory of RTC subsidiaries included in SIMAN.

We identified the remaining 269 subsidiaries through our comparison of DRR's, DOF's, and the Legal Division's subsidiaries inventories and our review of the closing records of 21 FDIC-established financial institution receiverships. Of the 269 subsidiaries, 218 were included on DOF's and/or the Legal Division's subsidiaries inventories. We identified the remaining 51 subsidiaries during our review of the closing records of the 21 FDIC-established financial institution receiverships. The majority of the 51 subsidiaries that we identified were involved in the businesses of real estate and other investments.

As shown in table 1, there were 1,636 NESC-managed subsidiaries in SIMAN as of February 25, 1999, and the 302 subsidiaries that the NESC added from the SIMAN Project brought the total to 1,938. The 429 (160 identified by the NESC and 269 identified by our audit) subsidiaries discussed in this report that were not included in SIMAN brings the total NESC-managed subsidiaries to 2,367. Accordingly, when our audit began, 31 percent (731 of 2,367) of the NESC-managed subsidiaries were not included in SIMAN—the FDIC's system of record for subsidiaries. The NESC's SIMAN Project reduced the NESC-managed subsidiaries not included in SIMAN to 18 percent (429 of 2,367).

Evidence of Asset Searches Not Available

Although NESC officials reported adding 302 subsidiaries to SIMAN, we could not determine whether asset searches were performed for those subsidiaries. Without adequate asset searches, subsidiaries' assets may not be identified and properly managed and liquidated. NESC officials stated that asset searches were not always needed because account officers would only dissolve subsidiaries that have no assets. They also stated that some states require subsidiaries to have zeroed balance sheets before obtaining a certificate of dissolution. Although NESC officials cited state laws requiring zeroed balance sheets before subsidiaries can be dissolved, many states do not have such a requirement. Specifically, five of seven Northeast States that we tested did not have that requirement.

LEXIS/NEXIS incorporation information was only available on 293 of the 429 subsidiaries not included in SIMAN. Our analysis of that information for the 293 subsidiaries showed that 38 were active, 34 were merged with other entities, 159 were voluntarily dissolved by the NESC or its contractors, and the remaining 62 were involuntarily dissolved by the cognizant states. We also could not determine whether asset searches were performed on the 429 subsidiaries not included in SIMAN. Other FDIC offices and/or contractors previously managed the majority of the 731 subsidiaries that were not in SIMAN at the time our audit began. Accordingly, without evidence that asset searches were performed, the NESC cannot be assured that all subsidiary assets were identified, whether from resolved or unresolved subsidiaries.

The results of our audit showed the importance of performing asset searches. For example, we identified assets belonging to subsidiaries dissolved or sold before the parent institutions failed and to active subsidiaries. Although the dollar amounts were not shown, our limited review of the unclaimed property databases reported on the Internet for the states of Florida, New York, and Rhode Island disclosed that 234 accounts belonged to subsidiaries. We were unable to determine the dollar value of these accounts because the state databases did not disclose them. Information on these 234 accounts is as follows:

- 43 accounts remained unclaimed belonging to a subsidiary that was dissolved before its parent financial institution failed,

- 139 accounts remained unclaimed belonging to a sold subsidiary (the accounts may have been sold along with the subsidiary or may still belong to the FDIC), and

- 52 accounts remained unclaimed belonging to 20 dissolved subsidiaries.

We also noted that active subsidiaries held assets but could not find documentation relating to the disposition of those subsidiaries or assets. Specifically, we identified 10 active subsidiaries that belonged to Goldome Bank, an FDIC receivership. In November 1991, approximately 6 months after Goldome failed, 9 of the 10 Goldome subsidiaries had assets worth $44 million. The FDIC's office at South Brunswick, New Jersey, contracted with Niagara Portfolio Management Corporation to manage and dissolve those subsidiaries. Niagara's business plan called for selling those subsidiaries, which were computer equipment leasing and financial corporations. However, we did not find any sale documentation for the subsidiaries or the assets or evidence of asset searches. Moreover, as of July 1999, the states of incorporation showed no change in the incorporation status of those subsidiaries since 1988—3 years before Goldome failed.

The remaining Goldome subsidiary that we identified was Goldome Foundation—a charitable organization set up by Goldome. The only information that we found related to that subsidiary was a March 1998 e-mail from the NESC's Collateral Department to the head of the NESC's Subsidiary Department, which stated that the Collateral Department had located 150 shares of Eastman Kodak stock registered in the name of Goldome Foundation. At that time, the stock had not been booked as an asset. In November 1999, the NESC's Subsidiary Department identified a legal representative of the Goldome Foundation and transferred the stock to that individual.

CONCLUSIONS AND RECOMMENDATIONS

The NESC's inventory of subsidiaries belonging to FDIC-established receiverships for its geographic area of responsibility was not complete. Furthermore, we could not determine whether the NESC always performed asset searches for subsidiaries. Failure to perform asset searches could result in the loss of FDIC assets. Without a complete inventory of subsidiaries, the NESC could fail to properly manage and dispose of them. The fact that information was available in other FDIC divisions, which would have made the DRR's system of record for subsidiaries more accurate, also suggests a coordination problem among the FDIC divisions. We believe that a complete inventory of subsidiaries is important because the NESC is scheduled to close June 30, 2000, and transfer its remaining work to the Dallas Office. Much of the institutional knowledge related to the NESC's subsidiaries will be lost in that transfer. Accordingly, the OIG recommends that the Regional Director, NESC, take the following actions:

(1) Include in the SIMAN system the 429 subsidiaries identified during our audit (160 identified by the NESC but not added to SIMAN plus 269 identified by the OIG).

(2) Perform asset searches for the 731 subsidiaries identified during our audit (429 not included in SIMAN and 302 that the NESC added to SIMAN).

(3) Coordinate with DOF's Field Finance Center, Bank Account Control Unit, in Dallas, Texas, to identify and recover unclaimed accounts being held by states' unclaimed property offices that belong to subsidiaries of FDIC receiverships managed by the NESC.

(4) Coordinate with DOF and the Legal Division to maintain a complete inventory of NESC subsidiaries to be transferred to the Dallas Office.

CORPORATION COMMENTS AND OIG EVALUATION

On December 17, 1999, the Regional Director, NESC, provided a written response to a draft of this report. Because the response did not provide the requisites for management decisions, as defined in the Inspector General Act, we held additional discussions with NESC staff who were involved in managing the subsidiary program and assisted the Regional Director in preparing his written response. Office of Internal Control Management, NESC, and OIG representatives attended a January 18, 2000, meeting at the NESC and DRR headquarters representatives in Washington, D.C., participated via teleconference. The Regional Director then provided a revised response to the draft report, which we received on January 31, 2000. Although the Regional Director's revised response did not specifically state whether he agreed or disagreed with any of the recommendations, based on the text of his comments, we concluded that he generally disagreed with recommendation 1 but has taken some corrective action on recommendations 2, 3 and 4.

The Regional Director's response is presented as appendix I to this report. A summary of the Regional Director's revised response to draft recommendations 1, 2, 3, and 4 and our analysis follows.

Include in the SIMAN system the 429 subsidiaries identified by our audit (recommendation 1): The Regional Director agreed that the 429 subsidiaries identified in our report were not included in SIMAN; however, he did not believe that there was adequate business justification to add them to the system. The Regional Director stated that the 731 subsidiaries mentioned in our report (302 identified by the NESC and added to SIMAN during the course of our audit plus 429 identified by our audit) were resolved before the FDIC adopted SIMAN on April 9, 1996. He added that based on the cost of the conversion, the quality of the data, and the very limited use of the data, there is no business justification to add previously resolved subsidiaries to SIMAN. In addition, the Regional Director commented that the NESC has an accurate inventory of "**active**" subsidiaries for its geographic area of responsibility. He said that an April 9, 1996, memorandum entitled "Initial Loading of FDIC Entities into the Subsidiary Information Management

Network (SIMAN)" required that all "**active**" subsidiaries be converted to SIMAN by May 31, 1996, and the NESC met that requirement.

Although the Regional Director contended that the April 9, 1996, memorandum required the conversion by May 31, 1996, of all "**active**" subsidiaries, the memorandum used the word "unresolved" as opposed to the word "active." The memorandum stated:

> "All general information for corporations, trust, associations, joint ventures and partnerships should be loaded individually for all unresolved Subsidiary and JVP entities in this phase of the project."

Further, the Regional Director's response did not mention that the April 9, 1996, directive was revised by a June 16, 1997, memorandum from the Deputy Director, Asset Management Branch. The June 16, 1997, guidance required that service center personnel enter current information into each required SIMAN field for all unresolved entities. The memo further described unresolved entities as falling in four different status groups:

(1) Active—the entity is not operating, but has lower tier entities that are operating.

(2) Inactive—the entity is not operating, but is not ready to be placed in the dissolution process.

(3) Operating—the entity is conducting business and has employees.

(4) Dissolution-in-Process—at least one of the resolved criteria (final tax returns filed; disposition status reached; entities books closed—zero book value on receivership ledger) has been met.

Accordingly, based on the April 9, 1996, and June 16, 1997, memorandums, SIMAN should contain information on all unresolved entities instead of just "**active**" subsidiaries as stated by the Regional Director. Furthermore, we believe that as the FDIC's system of record for subsidiaries, SIMAN should contain information on all subsidiaries both resolved and unresolved.

The Regional Director stated that when the FDIC adopted the SIMAN system, a business decision was made to only convert existing unresolved subsidiaries and not add historical records to SIMAN. However, the April 9, 1996, and June 16, 1997, memorandums were not clear that only unresolved subsidiaries should be added to SIMAN. In fact, the June 16, 1997, memorandum refers to a June 2, 1997, SIMAN User Group meeting, which recommended that " . . . 44 data elements be required for subsidiaries not yet resolved and 3 data elements for dissolved entities." We held discussions with responsible NESC officials throughout our audit. During those discussions, the restrictive decision regarding not adding historical records to SIMAN that the Regional Director cited in his response never came up. In fact, as previously stated, the NESC added 302 previously dissolved subsidiaries to SIMAN during the course of our audit, which generally came from the same receiverships as the 429 that we identified. The NESC added those 302 subsidiaries because of its SIMAN Project. In a February 23, 1999, e-mail to the

OIG, the NESC's Assistant Regional Manager, Subsidiaries Unit, explained the SIMAN Project as follows:

> "The purpose was to establish the 'universe' of hopefully all 'FDIC' subs under the control of Westborough, Franklin, South Brunswick and COMB Contractors. In other words having all FDIC subs like what already exists for the RTC subs. . . . Unlike active subs where we populate 46 data fields these assets only had about 10 to 12 fields populated, just to establish them as a reference point and their ultimate status, e.g. dissolved. Obviously the data base already contained all of the original Hartford subs. . . . Actually those who will benefit most from this effort is Dallas when we consolidate into them next year."

During our January 18, 2000, meeting, NESC officials stated that a policy exception was obtained from DRR headquarters that permitted the addition of the 302 previously resolved subsidiaries. Moreover, the Regional Director's response stated that the policy exception allowed the NESC "to input only 14 of the 46 required fields." However, the officials could provide only e-mails between staff regarding how to add the subsidiaries as opposed to any written evidence of a policy exception that authorized the 302 subsidiaries to be added or limited them to 14 data fields in the process. On January 31, 2000, a DRR Assistant Director issued a memorandum (see appendix II) clarifying the June 16, 1997, memorandum as follows:

> " . . . 44 data elements should have been loaded for all active/unresolved (Unresolved) entities that FDIC had in its inventory as of April 9, 1996. After these entities had been resolved there are 3 data elements that must be loaded to complete the recording of the resolution process."

Further, we disagree with the Regional Director's assertion that the 731 subsidiaries were all resolved before the FDIC adopted the SIMAN tracking system on April 9, 1996. We identified 62 subsidiaries not included in SIMAN that were involuntarily dissolved by the states, at least 13 of which were dissolved in August 1998, more than 2 years after FDIC adopted the SIMAN system. This contradicts the Regional Director's assertion that the NESC met the requirements for loading all "**active**" subsidiaries by May 31, 1996, and that all of the 731 subsidiaries discussed in our report were resolved prior to the FDIC's adoption of SIMAN. Furthermore, the Regional Director stated that on or around November 22, 1999, the Legal Division conducted a review of the 38 subsidiaries that our report identified as active but not included in SIMAN. He said that the review found that four of the subsidiaries were sold and merged into Fleet Bank during the resolution of the Bank of New England. He added that

> " . . . it would **appear** (emphasis added) that 30 entities had been purchased by others and are being maintained by them or were merged into entities not owned by the FDIC. Information on the remaining 4 entities was not readily available . . . through normal sources."

The Regional Director's response indicates that the NESC is not sure about the status of 34 of the 38 entities and does not provide information regarding whether the 34 entities were resolved or active as of April 9, 1996.

The Regional Director concluded that the NESC has not seen any material benefit from having added the 302 subsidiaries to SIMAN and, therefore, it is neither productive nor cost effective to now add the 429 subsidiaries that we identified. However, the Regional Director provided a list of the 429 subsidiaries to the Dallas Office for historic reference. We disagree with the Regional Director's belief that there is no material benefit to be gained from adding the subsidiaries to SIMAN. SIMAN is also used for recording the final tax return dates for dissolved subsidiaries. Based on an ongoing audit of final tax returns for the NESC's dissolved subsidiaries, we could not find approximately 30 percent of the final federal and state tax returns for the NESC subsidiaries shown in SIMAN. If final tax returns have not been filed for dissolved subsidiaries included in SIMAN, the likelihood of tax returns not being filed for dissolved subsidiaries not included in SIMAN is even greater. Adding the 429 subsidiaries identified in this report to SIMAN would provide a better basis for tracking and ensuring that final tax returns have been prepared for all dissolved subsidiaries. We have provided to DOF a listing of the 429 subsidiaries in an ongoing audit of Final Tax Returns for NESC Dissolved Subsidiaries and plan to recommend that the Division of Finance research whether final tax returns have been filed for these subsidiaries.

Although the Regional Director's response contained the requisites for a management decision, we continue to believe that a system of record—which SIMAN has been designated—should include all entities that it is designed to track. Accordingly, we disagree with the Regional Director's management decision.

Perform asset searches for the 731 subsidiaries identified during our audit (429 identified by our audit and 302 identified by the NESC) (recommendation 2): The Regional Director stated that it has been DRR policy to perform asset and liability searches as part of the subsidiary management responsibilities and part of the dissolution process. In addition, he said that there are several other interdivisional checkpoints between DOF, DRR, and the Legal Division to ensure that all assets are properly recorded on the books and records of the subsidiary and receivership. He added that DOF is responsible for the accounting records of an individual subsidiary and receivership and is involved in the process of preparing final tax returns, as well as upstreaming any remaining assets. He concluded that those interdivisional controls, in conjunction with the asset searches that should have been performed in accordance with DRR policy, would preclude almost any instance whereby the FDIC abandoned a particular subsidiary asset. For that reason, the Regional Director concluded that it would not be cost effective or productive to duplicate asset searches for those 731 resolved subsidiaries. He added that asset and liability searches would only detect matters/assets that are of public record such as real estate, mortgages, tax liens, judgments, and lawsuits. He also stated that third party searches would not detect ownership of stocks, bonds, or other negotiable instruments. The Regional Director said that, notwithstanding the above, the NESC ordered asset and liability searches of a sample of 36 of the 302 subsidiaries that the NESC added to SIMAN. He said that the results of the searches identified one judgment of $14,380 obtained on August 31, 1995, by one of the subsidiaries that was dissolved on October 30, 1995. The Regional Director reported that additional research is needed to determine whether the judgment is collectible. In addition, the Regional Director reported that the NESC ordered new asset and liability searches for 62 of the subsidiaries that we identified that were involuntarily dissolved, but no assets were found.

Although the Regional Director asserted that it has been DRR's policy to perform asset and liability searches, we could not find any evidence of those searches in the files. If the evidence of those searches had been maintained, the additional efforts required to perform the 98 searches (36 plus 62) cited would not have been necessary. The Regional Director's comment that asset searches will not detect ownership of stocks, bonds, and other negotiable instruments is not accurate. Many holders of cash, bonds, and other negotiable instruments are required to turn those assets over to states' unclaimed property agencies if not claimed by the owners within established timeframes. In fact, we searched the Internet for unclaimed property in the states of Florida, New York, and Rhode Island and found over 230 unclaimed accounts belonging to 22 of the subsidiaries identified in our report. Recommendation number 3 for the NESC to coordinate with DOF's Bank Account Control Unit in the Dallas Office was directly related to this issue. Although the Regional Director's response contained the requisites for a management decision, we continue to believe that evidence of asset searches should be available to provide assurance that all assets have been identified. Furthermore, we believe that asset searches should include searching for unclaimed assets held by states' unclaimed property agencies. Accordingly, we disagree with the Regional Director's management decision.

Coordinate with DOF's Field Finance Center, Bank Account Control Unit in Dallas, Texas, to identify and recover unclaimed accounts being held by states unclaimed property offices that belong to subsidiaries of FDIC receiverships managed by the NESC (recommendation 3): The Regional Director responded that the NESC forwarded the OIG's list of unclaimed accounts to the Bank Account Control Unit (BACU), which has been actively pursuing this type of potential recovery for the past several years. The Regional Director stated that in August 1999, a formal Memorandum of Understanding (MOU) was executed between DRR and DOF to ensure that all receivership and subsidiary claims would be properly handled with the appropriate authority in place. The Regional Director added that as a matter of interest, BACU has already acted on the OIG's list that the NESC forwarded to BACU on November 18, 1999. He said that BACU has already filed over 1,500 claims in Florida and is preparing to file 950 additional claims in New York State.

The Regional Director's response implies that BACU had identified unclaimed accounts for the subsidiaries identified in this report and was in the process of filing claims for them. We have been working closely with BACU on a previous OIG audit of unclaimed property.[7] The MOU mentioned in the Regional Director's response was in response to that audit. We issued a management letter to DRR and DOF on February 9, 1999, and a final audit report on August 27, 1999, which recommended that DOF be assigned the responsibility for identifying and recovering unclaimed accounts and that DRR discontinue paying finders fees to third parties for identifying those accounts. The MOU was signed in September 1999, shortly after our report was issued. In addition, we provided the receiverships and subsidiaries databases that BACU was using in its

[7] Report entitled *Audit of Abandoned Assets Held by States' Unclaimed Property Agencies* (audit report number A99-038 dated August 27, 1999.

asset searches. We created the subsidiary database provided to BACU from SIMAN, and that database did not include any of the 429 subsidiaries identified in this report as not being in SIMAN. Along with the databases, we provided BACU lists of 1,638 unclaimed accounts in Florida, 2,307 accounts in California, and over 700 accounts in New York.

With respect to the Regional Director's statement that BACU has been pursuing that type of recovery for several years, BACU has for years kept track of known bank accounts and recovered funds from various entities such as law firms and title companies. However, as mentioned in our prior report, BACU is relatively new at searching for unclaimed property held by states' unclaimed property agencies. For example, as of March 1999, BACU reported that it had recovered $25,000 from the state of Maryland. Before that, most of the state-held unclaimed funds had been recovered through DRR's finders fee program, which generally paid fees to private investigators who identified and reported the unclaimed accounts for a percentage of the funds collected.

The Regional Director stated that the NESC sent a list of the unclaimed bank accounts discussed in this report to BACU on November 18, 1999, and that BACU reported that it had already identified many of those accounts. However, on January 14, 2000, we requested the most current database of subsidiaries that BACU was using and compared it with the listing of 731 subsidiaries discussed in this report. Of the 731 subsidiaries, 401 (55 percent) were not on the January 14, 2000, BACU database. After we discussed this issue with NESC officials at the January 18, 2000, meeting, the NESC again forwarded a list of the 731 subsidiaries to BACU for inclusion in the database. The Regional Director's response contained the requisites for a management decision.

Coordinate with DOF and the Legal Division to maintain an accurate inventory of NESC subsidiaries to be transferred to the Dallas Office (recommendation 4): The Regional Director responded that for several years, the NESC's Subsidiary Department has distributed a monthly report to the Legal Division and DOF reflecting the current and year-to-date inventory of all subsidiaries and the current status of each entity. He added that those reports ensure that there is a consistent focus toward meeting DRR priority resolutions and serve as a check to other areas relative to their understanding of current inventory. He said that the NESC intends to continue this practice until all NESC subsidiaries have been dissolved or consolidated into the Dallas Office. The Regional Director said that on January 14, 2000, the NESC submitted a list of the 731 subsidiaries discussed in our report to DRR and DOF in the Dallas Office. We believe that the Regional Director's action meets the requirements for a management decision.

The Regional Director also commented on table 1 of our draft report. His response indicates a general misunderstanding of the purpose of the table. Although we acknowledge in our report that each of the lists had different purposes, the Regional Director incorrectly assumed that we were trying to reconcile the various subsidiary lists from DOF, DRR, and Legal. This was not the case. As stated on page 3 of the report: "We merged the three inventories to obtain a consolidated list of 2,294 unduplicated subsidiaries that became the basis for our analysis." Although we orally explained this again during our January 18, 2000, meeting, the Regional Director still explained in his revised response why the different lists do not reconcile. The fact that the lists do not reconcile is irrelevant to determining the total number of unduplicated subsidiaries on the different lists. We used the lists to identify subsidiaries that were not included in SIMAN but were known to the different FDIC divisions at the NESC. As stated in the report, of the 429 subsidiaries not included in SIMAN, " . . . 218 were included on DOF's and/or the Legal Division's subsidiaries inventories."

Appendix III presents management's proposed action on our recommendations and shows that there is a management decision for each recommendation in this report.

FDIC
Federal Deposit Insurance Corporation
101 East River Drive, P.O. Box 280402, East Hartford, CT 06128 Division of Resolutions and Receiverships

January 31, 2000

TO: Carl S. Mays, Regional Director
Office of Audits
Office of the Inspector General

JRK

FROM: Jon Karlson, Regional Director
Division of Resolutions and Receiverships
Northeast Service Center

SUBJECT: Response to OIG Draft Report on the *Audit of the Northeast Service Center's Subsidiaries Inventory*, Audit Number 98-108

With regard to the subject draft report dated November 8, 1999 we are responding to your recommendations, as follows:

1) The NESC does, indeed, have an accurate and complete record of **active** subsidiaries for its geographic area of responsibility. It should be noted that the 731 subsidiaries mentioned in the OIG Draft Audit Report (OIG Report) were all resolved prior to the FDIC adopting the SIMAN tracking system. SIMAN was an RTC subsidiary tracking system that was adopted by the FDIC on April 9, 1996, as a result of the Best Practices review. The directive entitled, "Initial Loading of FDIC Entities into the Subsidiary Information Management Network (SIMAN)" required that all **active** subsidiaries be converted to SIMAN by May 31, 1996. The NESC met this requirement.

   When the SIMAN system was adopted, a business decision was made to only convert existing unresolved subsidiaries. The business decision specifically chose not to recreate historical records which in some cases go back to the mid 1980's. We feel that our existing policy and practices ensure that all assets are accounted for and that no material weakness or loss has resulted from the decision to only convert **active** subsidiaries to the SIMAN system. We have substantially reviewed all of the specific instances cited in the OIG Report. The results to date have found no instance that would lead us to conclude that DRR should convert all previously resolved subsidiaries.

   The NESC and DRR's Washington Office concurred that based on the cost of conversion, the quality of the data, and the very limited value of this data, there was no business justification to add those previously **resolved** subsidiaries to SIMAN.

There were, however, 302 resolved subsidiaries that were included in the total of 731 previously resolved subsidiaries that were added to SIMAN. This action was approved by the Washington Office as an exception to policy and was included in SIMAN because of what was deemed to be the NESC staff's familiarity with these records. The policy exception allowed this office to input only 14 of the 46 required fields. We concur that the OIG has correctly noted that the remaining 429 are not included in the SIMAN inventory. For historic reference, on January, 14,2000, we provided the Dallas office a copy of the list of the 429 subsidiaries that had been resolved prior to the implementation of SIMAN as the FDIC system of record. To date NESC has not seen any material benefit from having added to SIMAN the aforementioned 302 subsidiaries, therefore it is neither productive nor cost effective to now add the previously resolved 429 subsidiaries.

2) We believe that asset searches were performed on previously resolved subsidiaries. It has been FDIC DRR policy to perform asset and liability searches as part of the subsidiary management responsibilities and part of the dissolution process. In addition, there are several other interdivisional checkpoints between DOF, DRR and the Legal Division to ensure that all assets are properly recorded on the books and records of the subsidiary and receivership**.** As an example, the legal division is asked to provide a dissolution opinion on each subsidiary. As part of the Legal Services request, DRR must inform the Legal Division if there are any remaining assets so that a proper distribution to other potential creditors can be determined. Under DRR policy this would have required an asset search to be performed.

   The OIG Report states that an NESC official said that asset searches were not always needed. While not commenting on the statement, we reviewed current and past editions of the DRR Asset Manual. Longstanding DRR policy going back to the December 31, 1991, (revised) asset manual (copy attached) states that asset searches are required to be obtained prior to dissolution of a subsidiary. We are confident that this policy was adhered to with few exceptions and therefore can not support the cost of reordering the asset searches.

   Notwithstanding the above, we have performed a sampling of the 302 subsidiaries mentioned in the OIG Report. In this regard we ordered a random sampling of 36 asset and liability searches from the 302 previously resolved subsidiaries mentioned in the OIG Report. The results of the test indicated only one possible exception involving Leasemart Inc. a subsidiary dissolved on 10/30/95. It would appear that the subsidiary obtained a judgement on 8/13/92 in the amount of $14,380 representing the residual balance from a 1987-leased automobile that had been repossessed and sold. In as much as the parent financial institution went into receivership in 12/91 and the subsidiary handle by a third party contractor we will need to do further research on this 8 year old $14,000 subsidiary to determine whether or not it is collectible.

In addition, the OIG report identifies 62 of the 429 as having been involuntarily dissolved. Our review of these subsidiaries included ordering new asset and liability searches on the 62 in the states of their incorporation only with the results being that no assets were found.

Also, DOF is responsible for the accounting records of an individual subsidiary and receivership and is involved in the process of preparing final tax returns as well as upstreaming any remaining assets. These interdivisional controls, in conjunction with the asset searches that would have been performed in accordance with DRR policy, would preclude almost any instance whereby the FDIC abandoned a particular subsidiary asset. For these reasons it was deemed not to be cost effective or productive to duplicate asset searches on these 731 resolved subsidiaries. Particularly in light of the fact that, as illustrated by the attached chart, fully 99.9% of the 429 subsidiaries are from institutions closed prior to 1993.

It should be noted that asset and liability searches will only detect matters/assets which are of public record, e.g., ORE, Mortgages, Tax Liens, Judgements, Lawsuits, etc. Third party searches will not detect ownership of stocks, bonds or other negotiable instruments. In its report the OIG mentioned several specific asset related findings and we would provide the following information:

- On or around November 22, 1999, Legal conducted a preliminary review of the 38 corporations noted in the OIG Report (page 8) as "active", from the list of the 429 that were not placed on the SIMAN system. This review found that four of the active subsidiaries were sold and merged into FLEET Bank during the resolution of Bank of New England. In addition, it would appear that 30 entities had been purchased by others and are being maintained by them or were merged into entities not owned by the FDIC. Information on the remaining 4 entities was not readily available to us through normal sources. We have written directly to the states of incorporation for further information. Based on what we have learned from our review of the 34 we do not expect any findings when our correspondence to the states of incorporation are responded to.

- Page ten identifies several Goldome entities, with combined net worth's of $44 million, still showing as active in their state of incorporation, and that no disposition records were located relative to Niagara Asset Management's (COMB Contractor) sale of these corporations. We agree that that the records supporting the disposition of these subsidiaries could not be located. As part of the Legal divisions review process they identified that eight of nine Goldome entities are part of that group that appears to be managed and annual reports being filed by third parties outside of the FDIC. Neither Legal nor DRR could find any information about the current status of the one remaining entity (Jersey Computer and Financial Corp.). We can only conclude form this information that Niagara's disposition plans had actually been implemented and the subsidiaries sold or otherwise transferred to others.

Note: Information on VSB Investments was removed from the report.

- Page nine and ten of the OIG Report points to real estate assets owned by an entity known as VSB Investments, a subsidiary of Vanguard Savings Bank, which closed in March 1992. Attached to this response are copies of the VSB Investments dissolution case dated July 21, 1993 and Business plan dated March 11, 1993. What occurred is that DRR obtained authority to dissolve the subsidiary on August 30, 1993, and the accounting entries which reflected the upstream of remaining real estate assets did not occur until later. This is not unusual as the case request for dissolution, approval from the appropriate state authority, and accounting entries are three separate events that do not necessarily occur at the same time. These were not discovered assets as indicated in the OIG Report (see OIG footnote #4). The OIG Report seems to criticize an appropriate business transaction.

- The OIG Report also refers to an entity known as Goldome Foundation, and 150 shares of Eastman Kodak stock in the name of the entity (page 10). We concur with the comments and the ultimate disposition as described.

3) On November 18, 1999, we requested, and received, from your staff auditor the listing of possible unclaimed bank accounts as outlined on page nine of the OIG Report. However, neither the NESC nor the OIG could determine the amounts involved in these accounts, as ownership has to be documented fully before such information can be divulged. On the same date we referred the listing to DOF Field Finance Center, Bank Account Control Unit (BACU) for the proper pursuit and resolution *(Copy of communication attached).* The BACU has been actively pursuing this type of potential recovery for the past several years. In August 1999, a formal Memorandum of Understanding was executed between DRR and DOF to ensure that all Receivership and Subsidiary claims would be properly handled with the appropriate authority in place. As a matter of interest, the above mentioned listings that were sent on November 18, 1999 have already been responded to. BACU has already filed over 1,500 claims in Florida and are preparing to file additional 950 claims in New York State. These claims cover both Receiverships and Subsidiaries. The NESC – DRR on January 14,2000 submitted a copy of the complete list of 731 to Dallas – DOF and DRR.

4) For several years the NESC Subsidiary Department has distributed a monthly Report to Legal and DOF reflecting the current and year to date, inventory of all subsidiaries. The report also reflects the current status of each entity. These reports support the needs of these divisions and provide a consistent focus toward meeting DRR priority resolutions. It also serves as a check to the other areas relative to their understanding of current inventory. We intend to continue this practice until all NESC subsidiaries have been dissolved or consolidated into the Dallas Office. We see no functional reason to do anymore then what is currently being done at this point.

   The chart on page four of the OIG Report shows subsidiary inventory totals from DRR, DOF and Legal. This needs to be clarified as follows:

- DRR's Subsidiary Inventory as of February 25, 1999, consisted of all entities (resolved and unresolved) from the FDIC and RTC's closed offices mentioned in the OIG Report on page three. DOF's Subsidiary Inventory dated April 30, 1994, does not include the RTC Subsidiaries. DOF did not include RTC Subsidiaries in its inventory until January 1996. It should also be noted that not all of the subsidiaries and partnerships in DRR's inventory have financial statements. In some cases (for Partnerships and Non Wholly Owned Subsidiaries) we do not have the responsibilities of handling the financials. Therefore, these entities will not be in DOF's inventory but have been included in DRR's Subsidiary Inventory.

- Page one of the OIG Report states that you reviewed the inventory consisting of subsidiaries of failed institutions as well as partnerships and joint ventures in which those subsidiaries had an ownership interest. It should be noted that NESC's Legal Subsidiary Report dated April 20, 1999, does not include partnerships or joint ventures. The Legal Division's report only tracks those items relative to active and resolved corporate entities. On a monthly basis, DRR receives a copy of the Legal report and distributes it to the appropriate account officer. Due to the fact that not all subsidiaries are corporations, the Legal and DRR lists will not reconcile. It should also be noted that NESC's Legal Division inherited the FDIC and RTC's closing offices legal inventory. If these cases had been closed and the subsidiaries had been resolved, they would not have been included on Legal's list.

Note: Attachments are not included in this report.

Attachments

cc: Vijay G. Deshpande, Director, OICM - w/o attachments
Giovanni G. Recchia, Associate Director, Internal Review, DRR - w/o attachments
Joe Palladino, Regional Manager - w/o attachments
Jerry Dano, Assistant Regional Manager, Subsidiaries - w/o attachments
Patricia Selensky, Internal Review - w attachments
File

FDIC

Federal Deposit Insurance Corporation
550 Seventeenth Street, N.W.
Washington, DC 20429 **Division of Resolutions and Receiverships**

January 31, 2000

MEMORANDUM

TO: Assistant Managing Directors, Subsidiary Management
Assistant Regional Managers, Subsidiary Management

FROM: Richard H. Fischman, Assistant Director
Asset Management Branch

SUBJECT: Subsidiary Information Management Network (SIMAN) Data Maintenance Requirements Clarification

PURPOSE:

To clarify the previous SIMAN loading requirements as stated in the memorandum entitled "Subsidiary Information Management Network (SIMAN) Data Maintenance Requirements "dated June 16, 1997. (See Attachment # 1):

CLARIFICATION:

As stated in the overview section on the attached memorandum (See Attachment #1), the User Group convened on 6/2/97 to identify data elements necessary for reporting progress in resolving each subsidiary and related legal entity (Entities). The group recommended that 44 data elements be required for entities not yet dissolved/resolved (Resolved) and 3 data elements for resolved entities.

To clarify the above statement, 44 data elements should have been loaded for all active/unresolved (Unresolved) entities that FDIC had in its inventory as of April 9, 1996. After these entities had been resolved there are 3 data elements that must be loaded to complete the recording of the resolution process.

The original memorandum did not state that previously resolved FDIC entities were to be loaded into SIMAN. This fact was also included in the Best Practice Program and noted in the FDIC/RTC Transition Task Force's report to Committee on Banking and Financial Services, U.S House of Representatives and Committee on Banking Housing, and Urban Affairs U.S. Senate, dated June 30, 1995. Loading all of FDIC's previously resolved entities into SIMAN would not be cost effective and very time consuming.

If you have any questions regarding this memorandum please contact James E. Davis at (202) 898-6648 or Shawn J. Scott (202) 898-6681.

Note: Attachment is not included in this report.

Attachment

cc: Program Managers, Subsidiary Management
James E. Davis
James E. Crum
Robert Manning
Pauline Hildebrandt
Alan Levy
Shawn J. Scott
SIMAN User Group

MANAGEMENT RESPONSES TO RECOMMENDATIONS

The Inspector General Act of 1978, as amended, requires the OIG to report on the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider the FDIC's responses as management decisions in accordance with the act and related guidance, several conditions are necessary. First, the response must describe for each recommendation

- the specific corrective actions already taken, if applicable;
- corrective actions to be taken together with the expected completion dates for their implementation; and
- documentation that will confirm completion of corrective actions.

If any recommendation identifies specific monetary benefits, FDIC management must state the amount agreed or disagreed with and the reasons for any disagreement. In the case of questioned costs, the amount that the FDIC plans to disallow must be included in management's response.

If management does not agree that a recommendation should be implemented, it must describe why the recommendation is not considered valid.

Second, the OIG must determine that management's descriptions of (1) the course of action already taken or proposed and (2) the documentation confirming completion of corrective actions are responsive to its recommendations.

This table presents the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on management's written response to our report.

Rec. Number	Corrective Action: Taken or Planned / Status	Expected Completion Date	Documentation That Will Confirm Final Action	Monetary Benefits	Management Decision: Yes or No
1	The Regional Director agreed that the 429 subsidiaries identified in our report were not included in SIMAN—the FDIC's system of record for subsidiaries. However, he did not believe that there was adequate business justification for adding the 429 subsidiaries to SIMAN.	01/31/00	Regional Director's response.	$-0-	Yes
2	Although the NESC could not provide copies of the asset searches, the Regional Director stated that the NESC stands by its assertions that it has been DRR policy to perform asset searches as part of the subsidiary management and dissolution process. The Regional Director concluded that because of interdivisional controls, in conjunction with asset searches that should have been performed in accordance with DRR policy, he could not support reordering asset searches. The Regional Director reported that, notwithstanding	01/31/00	Regional Director's response.	$-0-	Yes

Rec. Number	Corrective Action: Taken or Planned / Status	Expected Completion Date	Documentation That Will Confirm Final Action	Monetary Benefits	Management Decision: Yes or No
2 (cont'd.)	the above, the NESC ordered new asset and liability searches for a random sampling of 36 of the 302 subsidiaries identified by the NESC and found a $14,380 judgment obtained by one of the subsidiaries, which required further research to determine whether it is collectible. The Regional Director also reported that the NESC ordered new asset searches in the states of incorporation for the 62 involuntarily dissolved subsidiaries included in the 429 that we identified, but no assets were found.				
3	The Regional Director stated that on January 14, 2000, the NESC submitted a list of the 731 subsidiaries discussed in our report to both DOF and DRR in the Dallas Office.	01/14/00	Regional Director's response.	$-0-	Yes
4	The Regional Director stated that the NESC distributes a monthly report to the Legal Division and DOF reflecting the current and year-to-date inventory of all subsidiaries and the status of each entity. He said that the NESC intends to continue this practice until all NESC subsidiaries have been dissolved or consolidated into the Dallas Office.	01/31/00	Regional Director's response.	$-0-	Yes