

Office of Inspector General



June 30, 2000
Audit Report No. 00-025

**Audit of the Northeast Service Center's
Collateral Vault**





DATE: June 30, 2000

TO: A. J. Felton, Deputy Director
Division of Resolutions and Receiverships
Dallas Field Operations Branch

Bruce S. Simpson

CS

FROM: Carl S. Mays
Regional Director

SUBJECT: *Audit of the Northeast Service Center's Collateral Vault* (Audit Report No. 00-025)

This report presents the results of the Office of Inspector General's (OIG) audit of the Northeast Service Center's (NESC) collateral vault. The audit addressed whether the NESC's collateral and safekeeping inventory reports accurately matched the contents of the NESC's collateral vault. We performed this audit because the NESC's workload will transfer to the Dallas Office by June 30, 2000. Accordingly, the need for an accurate vault inventory is even greater because of the institutional knowledge that will be lost when the NESC closes.

BACKGROUND

The Federal Deposit Insurance Corporation's (FDIC) Division of Resolutions and Receiverships (DRR) has responsibility for managing and disposing of the assets of failed financial institutions. DRR's Notes, Collateral, and Safekeeping Department in Receivership Management (Customer Service) has the specific responsibility for maintaining the NESC's collateral vault.

The DRR *Collateral and Document Procedure Manual* requires DRR to track collateral items and documents from failed financial institutions through collateral inventory systems. DRR used Liquidation Asset Management Information System¹ (LAMIS) numbers for tracking collateral from receipt through the placement of collateral into sales initiatives and returning of the collateral to the rightful owner. Three computerized systems are used to track collateral and capture information such as the financial institution's name, financial institution's number, borrower's name, asset number/LAMIS number, and a detailed description of each piece of collateral. Those systems and their purposes are:

- **Safekeeping System:** accounts for jewelry, money, documents, savings bonds, and other valuable items taken from safety deposit boxes at the time the FDIC closes a financial institution.

¹The FDIC replaced LAMIS with the National Processing System (NPS). At the time of conversion, NPS used the existing LAMIS numbers as NPS numbers.

- **Possessory Collateral System:** accounts for possessory (negotiable) collateral such as certificates of deposit, stocks, and bonds.
- **Collateral Vault-REMATS:** accounts for nonnegotiable collateral such as security agreements, guarantees, and nonnegotiable securities.

During 1997 and 1999, DRR's Office of Internal Review (OIR) performed three reviews specifically related to the NESC's collateral vault. A report issued February 10, 1998 compared the vault file contents to the description on the applicable inventory reports. OIR recommended that the NESC (1) inventory the files and create an accurate database and (2) prepare an accurate and complete inventory sheet for each collateral file and provide a more detailed description of items on the safekeeping system. OIR additionally recommended that vault personnel attempt to identify and notify owners of safekeeping items and then escheat or destroy the safekeeping contents in accordance with state statute.

On June 24, 1999, OIR issued a report on a review to determine compliance with all directives, policies, and procedures relative to the Chief Financial Officers Act (CFOA) and the implementation of effective internal control programs and systems. Specifically, it reviewed a CFOA high-risk element: "Notes, Collateral, and Safekeeping items are not properly inventoried and safeguarded." OIR did not find any compliance exceptions with its review of possessory and safekeeping items. However, during OIR's review, DRR's Customer Service Department identified a 10-percent error rate between the nonnegotiable collateral file and the corresponding inventory report. Customer Service immediately initiated a project to correct the errors between the files and the nonnegotiable collateral database.

Before issuing its report on June 24, 1999, OIR performed a follow-up to Customer Service's review and found a 6-percent error rate. Accordingly, OIR continued to withhold certifying nonnegotiable collateral to NESC's management pending Customer Service's completion of the correction project.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our audit objective was to determine whether the NESC maintained an accurate inventory of its collateral vault. To accomplish our objective, we interviewed NESC personnel, reviewed OIR reports and working papers specifically related to the collateral vault, and compared samples of possessory and nonnegotiable collateral and safekeeping items to the inventory records.

Our review disclosed that the inventory for possessory collateral contained over \$7.9 million in certificates of deposit, savings passbooks, and money market accounts from financial institutions that subsequently failed—some of which failed over 7 years earlier. Because those instruments are readily convertible to cash, we expanded the scope of our audit to determine the status of that collateral. Accordingly, we selected a sample of 10 high-dollar items of possessory collateral, which we provided to the Regional Manager for Credit to determine the status of those items.

We determined the audit universe and both randomly and judgmentally selected samples from reports provided by Customer Service for possessory and nonnegotiable collateral and safekeeping items. Table 1 summarizes the universe and our samples taken from the inventory reports, vault folders, and contractor files that were stored in the collateral vault as of November 29, 1999.

Table 1: Collateral Vault Universe as of November 29, 1999, and OIG Audit Samples

Inventory Type	Universe per Inventory Reports	Sample Taken from			Total Sample Taken
		Inventory Reports	Vault Folders	Contractor Files	
Safekeeping items	276	18	5	0	23
Possessory collateral	901	58	10	0	68
Nonnegotiable collateral	3,291	100	12	11	123
Total	4,468	176	27	11	214

Source: NESC's inventory reports and OIG analysis.

We both randomly and judgmentally selected and reviewed 23 of 276 (8 percent) safekeeping records, 68 of 901 (8 percent) possessory collateral items, and 123 of 3,291 (4 percent) nonnegotiable collateral items. Included in the 68 possessory collateral items are 10 items of possessory collateral with LAMIS numbers that we selected, based on high-dollar values. Of the 123 nonnegotiable collateral items, we purposely selected 11 Knutson-managed collateral items, 8 of which did not have LAMIS numbers, because Customer Service had not incorporated the Knutson folders into the nonnegotiable file cabinet. Vault personnel stated that Knutson, a terminated loan servicer, sent the collateral items to the NESC's collateral vault upon termination of its contract. In addition to comparing those items between the collateral reports and vault folders, we had the NESC's Regional Manager for Credit provide status reports on the disposition of the 10 items of possessory collateral and 11 Knutson-managed collateral folders.

When an outcard was in the place of a vault folder, we requested back-up documentation on the current location of the collateral. Because bulk sales accounted for most of the outcards, we obtained the lists of assets for the designated bulk sales and verified the asset name to the applicable bulk sales list.

We did not evaluate DRR's internal controls over the collateral vault because

- OIR's CFOA review dated June 24, 1999 found no material weaknesses in the implementation of effective internal controls;
- the NESC was scheduled to close on June 30, 2000; and

- we concluded that we could meet the audit objectives more efficiently by conducting substantive tests.

We conducted the audit from November 1999 to January 2000 in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

The NESC's safekeeping report accurately listed safekeeping items. However, possessory and nonnegotiable collateral did not always have identification numbers that linked that collateral to associated loans. In addition, possessory and nonnegotiable collateral items that the NESC should have removed from the vault were not released and were still listed in the collateral reports. Moreover, the nonnegotiable collateral report continued to have large numbers of errors. The NESC's management generally took immediate action to correct discrepancies that we identified.

NESC's Collateral Report Did Not Always Have Related Loan Numbers

In the NESC's possessory collateral report dated November 30, 1999, 37 percent (337 of 906)² of the items of possessory collateral had no LAMIS or other identification number. Similarly, 30 percent (975 of 3,291) of the items of nonnegotiable collateral had bar codes instead of LAMIS numbers.³ Without a LAMIS number, when a loan disposition takes place, the credit specialist may not know that the loan has collateral and that he or she needs to authorize the release of that collateral to the rightful owner. Upon notification, the NESC's Regional Manager for Operations took immediate action. He assigned staff to determine the LAMIS number for each possessory collateral item and establish the status of the collateral.

NESC Maintained Collateral Documents After the Disposition of Associated Assets

The NESC's vault contained over \$42 million in (1) certificates of deposits, passbooks, and money market certificates; (2) cosurety and state housing authority bonds; and (3) publicly traded stocks that were pledged as collateral. Many items were from financial institutions that failed over 7 years earlier. In addition, we found nonnegotiable collateral previously managed by Knutson, a terminated loan servicer. Although the loans associated with that collateral were paid, compromised, or written off, the NESC had not removed the underlying collateral from either the vault or the possessory and nonnegotiable collateral databases. Accordingly, collateral documents were maintained after the disposition of the associated loans.

²The printed version of the negotiable collateral report had 901 items, but the electronic version contained 906 items.

³The Collateral Vault-REMATS computer system automatically assigns REMATS bar code locator numbers when DRR personnel do not enter LAMIS numbers into the nonnegotiable inventory.

In response to our request for information on the status of 10 high-dollar, possessory items, the Regional Manager for Credit found that NESC had accounted for all 10 items but did not dispose of them. For example, the FDIC liquidated five certificates of deposit and savings passbooks totaling \$1.1 million and applied the proceeds to the loan balances. In addition, an institution offset a \$200,000 certificate of deposit against the loan before the institution failed. However, the NESC kept each document in the collateral vault after they had been used to reduce the amounts of the related loans.

In response to our request for information on the status of 10 Knutson-managed, nonnegotiable collateral items, the NESC's Regional Manager for Credit found that

- five of the nonnegotiable items (e.g., mortgages and security deeds of trust) were sold and the collateral documents were returned in error to the FDIC;
- the FDIC could not locate any information on three of the nonnegotiable items; and
- the FDIC properly wrote off two nonnegotiable items in 1997 and 1998, respectively.

In commenting on the reviews of the high-dollar, possessory and Knutson-managed, nonnegotiable collateral items, the NESC's Regional Manager for Credit stated that DRR should research the collateral in the vault and determine which items it should remove.

NESC's Nonnegotiable Collateral Report Was Not Accurate

Excluding the Knutson errors mentioned above, our December 1999 analysis showed an error rate in the nonnegotiable collateral report of 29 percent (33 of the 112 sampled items). In June 1999, Customer Service found a 10-percent error rate in the nonnegotiable collateral report and immediately initiated a project to correct the errors. Before issuing a report on June 24, 1999, OIR followed up on Customer Service's review and found that the error rate had decreased to 6 percent. However, OIR withheld from the NESC's management a certification that nonnegotiable collateral was accurate, pending total correction of the files and database by Customer Service.

With regard to our December 1999 analysis, we found that vault personnel had placed outcards in vault folders for 31 items of collateral recently checked out to the NESC's Asset Sales for inclusion in scheduled bulk sales. The FDIC subsequently sold the 31 assets, but vault personnel did not pull the outcards and update the nonnegotiable collateral report to reflect the sale. Vault personnel sent another asset to a servicer but did not update the nonnegotiable collateral report to reflect that transfer. For the last asset, the required inventory list was not in the file folder. After we notified Customer Service of the 33 errors, vault personnel immediately corrected the vault folders and nonnegotiable collateral database for those errors.

CONCLUSIONS AND RECOMMENDATIONS

The NESC's safekeeping inventory was accurate. However, the NESC's collateral reports for reporting inventories of possessory and nonnegotiable collateral were not reliable.

Approximately 37 percent of the possessory collateral and 30 percent of the nonnegotiable collateral reports did not contain LAMIS numbers. The possessory and nonnegotiable collateral file folders and related inventory reports contained items that should have been removed from the collateral vault but were still there. Those items included collateral for assets that DRR had sold, compromised, settled, paid in full, sent to a loan servicer, or foreclosed. Finally, the nonnegotiable collateral report also had a high error rate. Accordingly, we recommend that the Regional Director, NESC, take the following actions:

- (1) Continue to identify the missing LAMIS numbers for the possessory and nonnegotiable collateral items.
- (2) Continue to identify the status of the possessory and nonnegotiable collateral items and, as applicable, correct the collateral databases and return the items to the rightful owner.
- (3) Notify the DRR Dallas Office of any unresolved discrepancies that the NESC transfers to that office.

CORPORATION COMMENTS AND OIG EVALUATION

On June 8, 2000, the Deputy Director, DRR, Dallas Field Operations Branch, provided a written response to a draft of this report. The Deputy Director stated that senior NESC management was aware of the inaccuracy of the NESC's collateral inventory since late 1996 and had been working on a long-term resolution plan. According to the Deputy Director, the resolution plan included regular follow-up reporting and reviews by the NESC's Internal Review Department. The Deputy Director also indicated that final actions on the recommendations were completed.

The Deputy Director's response agreed with the recommendations in the draft report and provided the requisites for a management decision on each of the three recommendations. The Deputy Director's response is not summarized because the actions planned or completed are identical to those recommended. The response is presented as appendix I to this report.

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



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APPENDIX I

Division of Resolutions and Receiverships

June 8, 2000

TO: Carl S. Mays
Regional Director
Office of Audits
OIG

FROM: A.J. Felton 
Deputy Director Field Offices
Division of Resolutions and Receiverships
Dallas Field Office Branch, Dallas, Texas

SUBJECT: Response to OIG Draft Report on the Audit of the Northeast Service Center's Collateral Vault, Audit Number 99-106

Regarding the subject draft report dated May 18, 2000, we are submitting our response directly to you for consideration, in response to the OIG's conclusions and recommendations.

Senior management of the Northeast Service Center (NESC) was aware of the "inaccuracy of NESC's collateral inventory" since late 1996. Beginning in 1996 the Operations Department presented the Regional Director with a long-term resolution plan; subsequently, the collateral vault personnel were required to provide the NESC senior management Audit Committee with regular follow-up reports on the status of all actions taken to correct the identified deficiencies during 1997 and 1998. Additionally, senior management requested the Internal Review Department of the NESC to complete a comprehensive review of the collateral vault unit in 1997, with two follow-up reviews scheduled in 1998, and a comprehensive review scheduled in 1999. The NESC management and personnel were committed to correcting all collateral vault deficiencies.

We believe the result of the NESC's continued commitment to resolving these deficiencies is reflected in the most recent review of this area. The Customer Service/Collateral Vault/Research Review of the NESC, conducted by the Office of Internal Review, DRR Dallas Field Office Branch, (DFOB) in March/April 2000, determined an overall error rate of zero (0.00%) percent. This review was performed specifically for the office closing and consolidation of the NESC into the DFOB by June 30, 2000.

Hence, our response to the OIG recommendations are the following:

Recommendation #1: "Continue to identify the missing LAMIS numbers for the possessory and non-negotiable collateral items."

- **Recommendation completed on March 28, 2000.**

Recommendation #2: "Continue to identify the status of the possessory and non-negotiable collateral items and, as applicable, correct the collateral databases and return the items to the rightful owner."

- **Recommendation completed March 22, 2000.**

Recommendation #3: "Notify the DRR DFOB of any unresolved discrepancies that the NESC transfers to that office."

- **Recommendation completed effective April 19, 2000.**

The NESC successfully coordinated its efforts with the DFOB to ensure an accurate and complete inventory of NESC possessory, non-negotiable collateral items, and safekeeping items for transfer. Personnel from the DFOB completed the inventory of the NESC's collateral vault and boxed and sealed the inventory for shipment on April 19, 2000. On April 25, 2000, all of the NESC collateral vault inventory was transferred to DFOB. Larry Greer, of the Inwood Branch of the DFOB, confirmed receipt of the shipment on April 28, 2000.

Cc: John Recchia
Rick Hoffman

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 Deputy Director responded that the NESC has identified missing LAMIS numbers for its possessory and nonnegotiable collateral items.	03/28/00	Collateral inventory report showing a LAMIS number for each item.	-0-	Yes
2	The Deputy Director responded that the NESC has determined the current status of its possessory and nonnegotiable collateral inventory items, corrected its collateral database, and returned items to rightful owners, as appropriate.	03/22/00	Collateral inventory report showing the status of each item.	-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
3	The Deputy Director responded that the NESC has successfully coordinated with the DRR, Dallas office to ensure an accurate and complete inventory of the NESC's possessory and nonnegotiable collateral and safekeeping items for transfer. He added that the NESC's collateral vault inventory was boxed and sealed for shipment to the Dallas office on April 19, 2000.	04/19/00	Dallas office's receiving report for NESC's collateral vault inventory.	-0-	Yes