



Office of Inspector General

Semiannual Report to the Congress

October 1, 2002 - March 31, 2003

FDIC Office of Inspector General Strategic Plan Framework (2003-2007)

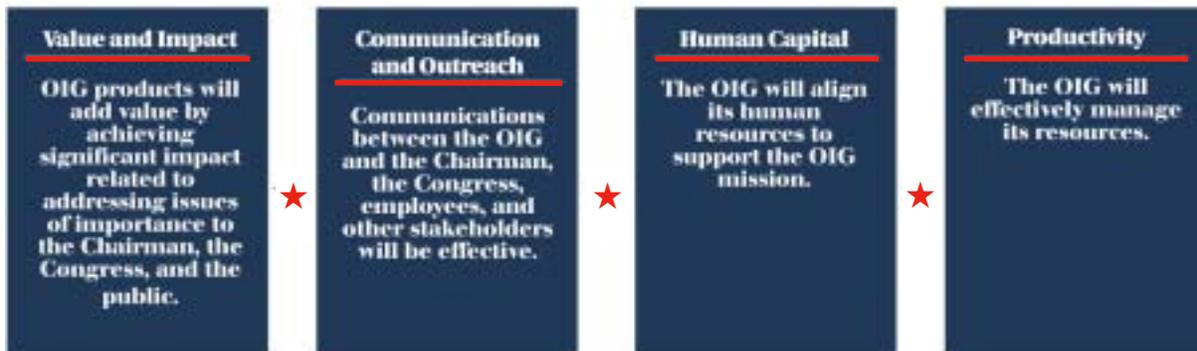
Vision

The agency and Congress see us as a valuable part of the Corporation and we are viewed as one of the best OIGs in government.

Mission

The Office of Inspector General promotes the economy, efficiency, and effectiveness of FDIC programs and operations, and protects against fraud, waste, and abuse, to assist and augment the FDIC's contribution to the stability of, and public confidence in, the nation's financial system.

Strategic Goals



Strategic Objectives



Core Values





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to the Congress**
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Inspector General's Statement



As I write this statement, our military men and women are engaged in operations in Iraq. We honor the memory of brave Americans who have sacrificed their lives in that effort and appreciate all others who dedicate themselves to serving our country in the military. Their commitment to our nation deepens the pride that we feel as public servants carrying out the mission of the Office of Inspector General (OIG) at the Federal Deposit Insurance Corporation (FDIC).

In that regard, my statement for this 6-month period focuses on the Corporation's progress in areas that the OIG previously identified and areas where further actions are necessary. During the period, FDIC Chairman Donald Powell continued to provide strong leadership and direction to the Corporation. His *1st Quarter Letter to Stakeholders* articulated the corporate priorities for 2003: **Stability** of the industry and the insurance funds, **Sound Policy** positions supported by substantive research and led by comprehensive deposit insurance reform legislation, and **Stewardship** of the Corporation and insurance funds to ensure that the FDIC does its job in the most efficient and effective manner possible. The OIG supports and will continue efforts to further these priorities through our audits, evaluations, and investigations.

The priorities outlined above warrant attention of the highest governance level of the FDIC—the Board of Directors. Again, I express my concern over an FDIC Director vacancy going back to September 1998. The balance between the various interests implicit in the Board's structure is preserved only when all Board positions are filled. I continue to believe that the overall governance of the Corporation would be best served by filling the vacant position so that a full Board is in place to pursue corporate priorities.

A notable area where the Corporation has continued to make progress during the reporting period relates to the FDIC's efforts to contain organizational costs. Corporate downsizing, reorganizations in both headquarters and field sites, office closings, and plans for a new Virginia Square facility to house FDIC employees are just some of the successful measures undertaken to

reduce organizational costs and increase efficiencies. Now, with more organizational stability, the Corporation can increase attention given to operational costs as well—that is, more fully integrating cost considerations into day-to-day decision making. The OIG first identified the challenge of assessing business processes and containing costs as a Major Issue in our April 2001 semiannual report and will continue to foster the Corporation's initiatives in this area.

The Corporation has also made progress in the information security area. As highlighted in our last semiannual report, based on the results of our 2002 Government Information Security Reform Act evaluation, we listed 10 steps that the Corporation could take in the near term to improve information security. We advised that one such step would be to strengthen accountability and authority for information security by appointing a permanent Chief Information Officer who would report directly and solely to the Chairman and by filling key vacancies within the Division of Information Resources Management (DIRM) that support information security initiatives and operations. The Corporation has filled a number of DIRM vacancies since that time and is now actively seeking a Chief Information Officer.

A second step involved completing an enterprise architecture to document current and desired relationships among business and management processes and information technology. Again, the Corporation has progressed in this area by devoting resources, developing policies, and preparing an enterprise architecture blueprint. These actions have set the stage for an enterprise architecture that will facilitate planning and decision making and help improve information technology security. The Corporation now needs to sustain the momentum and actually establish such an architecture. A third critical step was ensuring contractor security, a vulnerable area given the FDIC's reliance on contractor support for information technology operations. Through the efforts of an FDIC task force, a number of policies and procedures are underway to better ensure security of contractor information and resources. Our office is monitoring corporate efforts to

address all information security concerns as part of our 2003 review under the Federal Information Security Management Act and will report results in the next semiannual period.

Turning now to the OIG's recent progress. During the past 6 months, we continued efforts to stabilize our organization and operations through downsizing measures that are now nearly complete. Despite our reduction in staff, we have managed to maintain and in some cases increase our productivity, and we continue to work cooperatively with corporate management and the FDIC Audit Committee on issues of mutual interest. Among our accomplishments during the reporting period, we issued 27 audit reports containing 90 non-monetary recommendations and nearly \$1.26 million in monetary benefits. OIG investigations resulted in 13 indictments/informations; 14 convictions; and approximately \$26.2 million in fines, restitution, and other monetary recoveries. We reported the results of our material loss review of the failure of Connecticut Bank of Commerce, an institution whose failure caused an estimated \$63 million loss to the insurance funds. We provided our assessment of the Most Significant Management and Performance Challenges to the Corporation and issued our 2003 Performance Plan, an ambitious strategic framework that drives OIG results. We also celebrated several noteworthy individual accomplishments during the reporting period: Mike Lombardi and Monte Galvin from our Office of Audits were honored at the Corporation's Annual Awards Ceremony in March 2003 with the Chairman's Award for Excellence for a Team Contribution, and the Nancy K. Rector Award for Public Service, respectively.

Going forward, the OIG will build on past accomplishments and continue to emphasize productivity, performance, process improvement, and people. Our office, established in 1989 by the FDIC Board of Directors pursuant to the Inspector General (IG) Act amendments of 1988, also looks forward to October 2003 when we will join with others in the IG community to mark the 25th anniversary of the IG Act of 1978. Charged with promoting economy, efficiency, effectiveness, and integrity in government programs and

operations, the community impacts society in positive ways. We at the FDIC OIG will be ready to celebrate our public service and recommit to our FDIC mission in the fall. I was sworn in as the IG at the FDIC 7 years ago to carry out the IG mission and have appreciated the support I have received from the Corporation, the Congress, and the FDIC OIG staff over the years. With their continued support, I am confident that we will successfully and cooperatively meet all challenges ahead.



Gaston L. Gianni, Jr.
Inspector General
April 30, 2003

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Overview



Management and Performance Challenges

The **Management and Performance Challenges** section of our report presents OIG results of audits, evaluations, and other reviews carried out during the reporting period in the context of the OIG's view of the most significant management and performance challenges currently facing the Corporation. We identified the following 10 management and performance challenges and, in the spirit of the Reports Consolidation Act of 2000, we presented our assessment of them to the Chief Financial Officer of the FDIC in February 2003. The Act called for these challenges to be presented in the FDIC's consolidated performance and accountability report. Our work has been and continues to be largely designed to address these challenges and thereby help ensure the FDIC's successful accomplishment of its mission.

- ☆ Adequacy of Corporate Governance in Insured Depository Institutions
- ☆ Protection of Consumer Interests
- ☆ Security of Critical Infrastructure
- ☆ Management and Analysis of Risks to the Insurance Funds
- ☆ Effectiveness of Resolution and Receivership Activities
- ☆ Management and Security of Information Technology Resources
- ☆ Assessment of Corporate Performance
- ☆ Transition to a New Financial Environment
- ☆ Organizational Leadership and Management of Human Capital
- ☆ Cost Containment and Procurement Integrity

OIG work conducted to address these areas during the reporting period includes 27 audit and evaluation

reviews containing both monetary and nonmonetary recommendations; comments and input to the Corporation's various performance plans and accountability reports; participation at meetings, symposia, conferences, and other forums to jointly address issues of concern to the Corporation and the OIG; and assistance provided to the Corporation in such areas as the conduct of the U.S. General Accounting Office financial statement audit and review of the Corporation's Internal Control and Risk Management Program. (See pages 11-32.)

Investigations

In the **Investigations** section of our report, we feature the results of work performed by OIG agents in Washington, D.C., Atlanta, Dallas, and Chicago who conduct investigations of alleged criminal or otherwise prohibited activities impacting the FDIC and its programs. In conducting investigations, the OIG works closely with U.S. Attorney's Offices throughout the country in attempting to bring to justice individuals who have defrauded the FDIC. The legal skills and outstanding direction provided by Assistant United States Attorneys with whom we work are critical to our success. The results we are reporting for the last 6 months reflect the efforts of 19 U.S. Attorney's Offices throughout the United States. Our write-ups also reflect our partnering with the Federal Bureau of Investigation, the Internal Revenue Service, Secret Service, and other law enforcement agencies in conducting investigations of joint interest.

Investigative work during the period led to indictments or criminal charges against 13 individuals and convictions of 14 defendants. Criminal charges remained pending against 14 individuals as of the end of the reporting period. Fines, restitutions, and recoveries stemming from our cases totaled almost \$26.2 million. This section of our report also includes information on a legislative proposal we have put forth to the Congress to enhance enforcement authority for misrepresentations regarding FDIC insurance. (See pages 33-42.)

OIG Organization

In the **Organization** section of our report, we note some of the significant internal activities that the FDIC OIG has recently pursued. Chief among these are (1) issuance of our Fiscal Year 2003 Performance Plan, which reflects an updated strategic framework with improved linkages to the FDIC Strategic Plan, the OIG Human Capital Strategic Plan, the OIG Office of Audits' Assignment Plan, and the OIG-identified Management and Performance Challenges referenced above and (2) efforts in furtherance of our Human Capital Strategic Plan related to competencies and the business knowledge and skills needed by OIG staff to provide maximum value to the Corporation. Activities of OIG Counsel and cumulative OIG results covering the past five reporting periods are also shown in this section. (See pages 43-51.)

Appendix

The Appendix of our report contains much of the statistical information required under the Inspector General Act, as amended. Additionally, the back section of our report features career accomplishments of some of our current and past FDIC OIG colleagues. Page 66 of our report highlights the IG community's results during fiscal year 2002. (See pages 54-end.)



Highlights



- ☆ The Office of Audits issues 27 reports containing total questioned costs of \$314,357 and funds put to better use of \$945,778.
- ☆ OIG reports include 90 nonmonetary recommendations to improve corporate operations and activities. Among these are recommendations to strengthen the examination process in key risk areas; improve the effectiveness of internal network controls; develop additional policy for procurement credit card activities; and enhance the regulatory oversight in the application process for mergers, acquisitions, or changes in control and in the advance notification of changes in bank management.
- ☆ The OIG reports positive results of audits related to the FDIC's Corporate Readiness Plan, examiner assessment of subprime lending, and examiner use of work performed by independent public accountants.
- ☆ OIG investigations result in 13 indictments/informations; 14 convictions; and approximately \$26.2 million in total fines, restitution, and other monetary recoveries. Approximately \$25.8 million of that amount represents court-ordered restitution and is an amount that has not yet been collected.
- ☆ In February 2003, the OIG provides the Chief Financial Officer the OIG's assessment of the Most Significant Management and Performance Challenges facing the Corporation, in the spirit of the Reports Consolidation Act of 2000. The OIG sharpens the focus of its work to address the challenges identified.
- ☆ The OIG issues its fiscal year 2003 Annual Performance Plan with improved linkages to the FDIC Strategic Plan, the OIG Human Capital Strategic Plan, the Office of Audits' Assignment Plan, and OIG-identified management and performance challenges.
- ☆ The Office of Audits issues its Assignment Plan for fiscal year 2003, focusing its work on the Corporation's principal business lines.
- ☆ The OIG continues to implement its Human Capital Strategic Plan for 2002-2006, focusing on development of OIG workforce competencies and administration of a business knowledge and skills inventory tool to all staff.
- ☆ The Offices of Inspector General of the FDIC, Department of the Treasury, and the Board of Governors of the Federal Reserve System sponsor the Second Emerging Issues Symposium, bringing together distinguished speakers who share their perspectives on the banking and financial services community with Inspector General staff in the interest of enhancing the value that OIGs can add to their respective agencies by successfully addressing risk areas.
- ☆ OIG counsel litigates one matter during the reporting period and provides advice and counsel on a number of issues. Counsel assisted the Corporation in litigating 1 matter and is involved in 23 litigation matters that are awaiting further action by the parties or rulings by the court or other adjudicatory bodies.
- ☆ The OIG reviews and comments on 1 proposed federal regulation and 35 proposed FDIC policies and directives and responds to 2 requests under the Freedom of Information Act. Substantive comments are provided to the Corporation related to proposed policies on various aspects of information technology security.
- ☆ The OIG reports the results of its Material Loss Review of the Failure of Connecticut Bank of Commerce, an institution that failed and may cause losses to the insurance funds of approximately \$63 million. The OIG identifies weak corporate governance at the institution as the principal cause of failure and makes five recommendations to improve the safety and soundness examination process and information available to examiners.
- ☆ In response to a request from Representative Michael G. Oxley, Chairman, Committee on Financial Services, U.S. House of Representatives,

to the Chairman of the FDIC for proposals for legislation to be considered by the Committee, the OIG submits two proposals. The first proposal is to amend the FDIC's enforcement authority in the Federal Deposit Insurance Act to authorize civil monetary penalties for misuse of the FDIC logo, abbreviation, or other commonly recognized symbols of federal deposit insurance. Second, the OIG proposes amending the Act to clarify the Inspector General's authority to conduct financial statement audits of the Corporation and the insurance funds.

- ☆ The OIG submits its fiscal year 2004 appropriation request to the Subcommittee on VA, HUD and Independent Agencies, Committee on Appropriations, U.S. House of Representatives. The OIG requests \$30.1 million for fiscal year 2004 to fund 168 staff.
- ☆ The OIG responds to a request from Senator Barbara Mikulski and confirms to her that the information the FDIC provided to the Congress related to outsourcing some of its Data Center positions was adequately supported.
- ☆ The OIG coordinates with and assists management on a number of initiatives, including offering advisory comments to management on the FDIC's 2003 Annual Performance Plan and 2002 Annual Report, Office of Investigations and Office of Audits Executives' participation at the Division of Supervision and Consumer Protection Field Office Supervisor meetings, and providing an updated risk analysis document on the *Quality of Bank Financial Reporting and Auditing and Corporate Governance*.
- ☆ The OIG accomplishes a number of internal office initiatives, including administering the OIG's Business Knowledge Inventory System, sharing best practices with other OIGs, issuing our 2002 Performance Report, and participating in numerous interagency working groups.

- ☆ Two OIG staff are among those honored at the Corporation's Annual Awards Ceremony. Mike Lombardi receives the Chairman's Excellence Award for Group/Team Contributions as part of the Risk Management Examination Process Redesign 2 (MERIT) Team, and Monte Galvin is the recipient of the Nancy K. Rector Public Service Award for her volunteer service to Habitat for Humanity.
- ☆ The OIG completes its annual review of the FDIC's Internal Control and Risk Management Program, concluding that the program was conducted in accordance with FDIC policy and consistent with provisions of the Federal Managers' Financial Integrity Act.
- ☆ As Vice Chair of the President's Council on Integrity and Efficiency, the Inspector General leads the Inspector General community's activities, participates as a presenter at numerous professional conferences and other forums, and shares information and best practices with delegations of foreign visitors.

Management and Performance Challenges



The Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the Congress to maintain stability and confidence in the nation's banking system by insuring deposits, examining and supervising financial institutions, and managing receiverships. Approximately 5,400 individuals within seven specialized operating divisions and other offices carry out the FDIC mission throughout the country. According to the Corporation's Letter to Stakeholders, issued for the 1st Quarter 2003, as of December 30, 2002, the FDIC insured \$3.387 trillion in deposits for 9,372 institutions. As of March 31, 2003, the FDIC supervised 5,354 institutions and held assets in liquidation of \$1.538 billion. There are 40 active receiverships in the Bank Insurance Fund and Savings Association Insurance Fund. The Corporation maintains insurance funds in excess of \$43 billion to ensure depositors are safeguarded.

In previous semiannual reports, we identified our view of the most significant issues facing the Corporation as it carries out its mission. Over the past 7 years, we have reported our work in the context of these major issues in our semiannual reports, largely in response to the request of various congressional Committees that OIGs identify these issues across the government. During the reporting period, we again considered these issues, but in a slightly different context. To explain—in the spirit of the Reports Consolidation Act of 2000, in February 2003, we provided the Chief Financial Officer (CFO) of the FDIC the OIG's assessment of “the most significant management and performance challenges” facing the Corporation. The Act calls for these challenges to be included in the FDIC's 2002 consolidated performance and accountability report.

We identified the following management and performance challenges:

- ☆ Adequacy of Corporate Governance in Insured Depository Institutions
- ☆ Protection of Consumer Interests
- ☆ Security of Critical Infrastructure

- ☆ Management and Analysis of Risks to the Insurance Funds
- ☆ Effectiveness of Resolution and Receivership Activities
- ☆ Management and Security of Information Technology Resources
- ☆ Assessment of Corporate Performance
- ☆ Transition to a New Financial Environment
- ☆ Organizational Leadership and Management of Human Capital
- ☆ Cost Containment and Procurement Integrity

Earlier, we shared a listing of these challenges with corporate offices and divisions. There are close parallels between our previously reported “major issues” and the challenges we presented in February. The Corporation's more recent comments on the challenges attested to the fact that the Corporation has had a number of actions underway to address each of the areas discussed, and we encouraged continued attention to all of these challenges. For its part, the OIG will continue to pursue audits, evaluations, investigations, and other reviews that address the management and performance challenges we identified. Our work during the reporting period can be linked directly to these challenges and is presented as such in the sections that follow. We will continue to work with corporate officials to successfully address each challenge.

Adequacy of Corporate Governance in Insured Depository Institutions

A number of well-publicized announcements of business failures, including financial institution failures, have raised questions about the credibility of accounting practices and oversight in the United States. These recent events have increased public concern regarding the adequacy of corporate governance and, in part, prompted passage of the Sarbanes-Oxley Act of 2002. The public's confidence in the nation's financial system

can be shaken by deficiencies in the adequacy of corporate governance in insured depository institutions. For instance, the failure of senior management, boards of directors, and auditors to effectively conduct their duties has contributed to some recent financial institution failures. In certain instances, Board members and senior management engaged in high-risk activities without proper risk management processes, did not maintain adequate loan policies and procedures, and circumvented or disregarded various laws and banking regulations. In other instances, independent public accounting firms rendered unqualified opinions on the institutions' financial statements when, in fact, the statements were materially misstated. To the extent that financial reporting is not reliable, the regulatory processes and FDIC mission achievement, that is ensuring the safety and soundness of the nation's financial system, can be adversely affected. For example, essential research and analysis used to achieve the supervision and insurance missions of the Corporation can be complicated and potentially compromised by poor quality financial reports and audits. Potentially the insurance funds can be affected by financial institution and other business failures involving financial reporting problems. In the worst case, illegal and otherwise improper activity by management of financial institutions or their boards of directors can be concealed, resulting in significant potential losses to the FDIC insurance funds.

The Corporation has initiated various measures designed to mitigate the risk posed by these concerns, such as reviewing the bank's board activities and ethics policies and practices and reviewing auditor independence requirements. In addition, the FDIC reviews the financial disclosure and reporting obligations of publicly traded state nonmember institutions as well as their compliance with other Securities and Exchange Commission regulations and the Federal Financial Institutions Examination Council-approved and recommended policies to help ensure accurate and reliable financial reporting through an effective external auditing program. Other corporate governance initiatives include the FDIC issuing Financial Institution

Letters, allowing bank directors to participate in regular meetings between examiners and bank officers, a "Director's Corner" on the FDIC Web site, and expansion of the Corporation's "Director's College" program. The adequacy of corporate governance will continue to require the FDIC's vigilant attention.

OIG Comments on Corporation's Inclusion of Corporate Governance Issues in Consolidated Annual Report

The OIG provided a substantive suggestion to the CFO and the Acting Director of the Office of Internal Control Management for consideration in the preparation of the Corporation's consolidated annual report. We suggested that the report include a discussion of the risks associated with bank corporate governance (including the quality of bank financial reporting and auditing) and the challenges of Sarbanes-Oxley Act implementation. To facilitate consideration of this matter, we provided a risk analysis document on March 10, 2003, entitled *2003 Update: FDIC Continuing Risk - The Quality of Bank Financial Reporting and Auditing and Corporate Governance*.

While we acknowledged in our analysis that the passage of the Sarbanes-Oxley Act of 2002 was a significant step in addressing corporate governance and accountability issues, the Act has not been fully implemented and its future effectiveness is not known. We believe the FDIC, along with other financial institution regulators should play an active role, along with the Securities and Exchange Commission, in implementation of Sarbanes-Oxley.

The nature of the corporate governance and financial reporting risks involves unknown quantities (e.g., the extent of unreliable data reported and extent of undetected fraud), and, as a result, the true magnitude and impact of the risks cannot be reasonably quantified or projected. However, the potential impact of the risks could be material and constitutes a significant vulnerability to the FDIC's ability to effectively achieve its insurance and supervision missions. Absent full and effective implementation of mechanisms, such as those envisioned under Sarbanes-Oxley (including a program

of effective oversight of the quality of independent public accounting audits), we believed reasonable assurance did not currently exist to conclude that the potential adverse impact of these risks could be prevented or avoided.

In consideration of our suggestion, the Corporation included a brief discussion of corporate governance in its report. The report noted various measures initiated to mitigate the risk of increased public concern regarding accounting practices and oversight and the adequacy of corporate governance, which, in part, prompted passage of the Sarbanes-Oxley Act of 2002. In particular, the report cited reviewing board activities, ethics policies and practices of the banks the FDIC supervises, and auditor independence requirements. The report also cited guidance issued by the FDIC in early 2003 to institutions about the Sarbanes-Oxley Act, including the actions that the FDIC encourages institutions to take to ensure sound corporate governance.

The issue of ineffective corporate governance was also identified in our Material Loss Review of the Connecticut Bank of Commerce as the main cause of the institution's failure (see write-up on page 16 of this report). Also in this connection, see our write-up of our audit of Examiner Use of Work Performed by Independent Public Accountants on page 20.

Protection of Consumer Interests

The FDIC is legislatively mandated to enforce various statutes and regulations regarding consumer protection and civil rights with respect to state-chartered, non-member banks and to encourage community investment initiatives by these institutions. Some of the more prominent laws and regulations in this area include the Truth in Lending Act, Fair Credit Reporting Act, Real Estate Settlement Procedures Act, Fair Housing Act, Home Mortgage Disclosure Act, Equal Credit Opportunity Act, Community Reinvestment Act of 1977, and Gramm-Leach-Bliley Act.

The Corporation accomplishes its mission related to fair lending and other consumer protection laws and

regulations by conducting compliance examinations, taking enforcement actions to address unsafe or unsound banking practices and compliance violations, encouraging public involvement in the compliance process, assisting financial institutions with fair lending and consumer compliance through education and guidance, and providing assistance to various parties within and outside of the FDIC.

The FDIC's examination and evaluation programs must assess how well the institutions under its supervision manage compliance with consumer protection laws and regulations and meet the credit needs of their communities, including low- and moderate-income neighborhoods. The FDIC must also work to issue regulations that implement federal consumer protection statutes—both on its own initiative and together with the other federal financial institution regulatory agencies. One important focus will be the Gramm-Leach-Bliley Act, as the Corporation must ensure it has a quality program to examine institution compliance with the privacy and other provisions of the Act.

The Corporation's community affairs program provides technical assistance to help banks meet their responsibilities under the Community Reinvestment Act. The current emphasis is on financial literacy, aimed specifically at low- and moderate-income people who may not have had banking relationships. The Corporation's "Money Smart" initiative is a key outreach effort. The FDIC must also continue efforts to maintain a Consumer Affairs program by investigating consumer complaints about FDIC-supervised institutions and answering consumer inquiries regarding consumer protection laws and banking practices.

The OIG's ongoing work in this area includes a review of the implementation of Gramm-Leach-Bliley Act customer privacy provisions. Results of this work will be presented in an upcoming semiannual report.

Security of Critical Infrastructure

The adequate security of our nation's critical infrastructure has been at the forefront of the federal



Symposium



Symposium



government’s agenda for many years. Specifically, the President’s Commission on Critical Infrastructure Protection (established in July 1996) was tasked to formulate a comprehensive national strategy for protecting the nation’s critical infrastructure from physical and “cyber” threats. Included among the limited number of systems whose incapacity or destruction were deemed to have a debilitating impact on the defense or economic security of the nation was the banking and finance system. With the increased consolidation and connectivity of the banking industry in the years since 1996, and with the new awareness of the nation’s vulnerabilities to terrorist attacks since September 11, 2001, the security of the critical infrastructure in the banking industry is even more important.

On May 22, 1998, the Presidential Decision Directive (PDD) 63 was signed, calling for a national effort to ensure the security of the nation’s critical infrastructures. PDD 63 defined the critical infrastructure as the “physical and cyber-based systems essential to the minimum operations of the economy and government.” President Bush declared that securing our critical infrastructure is essential to our economic and national security and issued two Executive Orders (EO 13228, The Office of Homeland Security and the Homeland Security Council and EO 23231, Critical Infrastructure Protection in the Information Age) to improve the federal government’s critical infrastructure protection program in the context of PDD 63.

The intent of PDD 63 is to ensure that the federal government maintains the capability to deliver services essential to the nation’s security, economy, and the health and safety of its citizens, in the event of a cyber- or physical-based disruption. Much of the nation’s critical infrastructure historically has been physically and logically separate systems that had little interdependence. However, as a result of technology, the infrastructure has increasingly become automated and interconnected. These same advances have created new vulnerabilities to equipment failures, human error, and natural disasters as well as terrorism and cyber attacks.

To effectively protect critical infrastructure, the FDIC’s challenge in this area is to implement measures to mitigate risks, plan for and manage emergencies through effective contingency and continuity planning, coordinate protective measures with other agencies, determine resource and organization requirements, and engage in education and awareness activities. The FDIC will need to continue to work with the Department of Homeland Security and the Finance and Banking Information Infrastructure Committee created by EO 23231 and chaired by the Department of the Treasury, on efforts to improve security of the critical infrastructure of the nation’s financial system.

The OIG is nearing completion of its review of the FDIC’s efforts to implement its Information Security Strategic Plan. This review is part of the President’s Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency Audit Committee’s review of the nation’s critical infrastructure assurance program. Our review objective is to evaluate the adequacy of the FDIC’s activities for protecting critical cyber-based infrastructures. We will issue the results of that work in our next semiannual report.

Management and Analysis of Risks to the Insurance Funds

A primary goal of the FDIC under its insurance program is to ensure that its deposit insurance funds do not require resuscitation by the U.S. Treasury. Achieving this goal is a considerable challenge, given that the FDIC supervises only a portion of the insured depository institutions. The identification of risks to non-FDIC supervised institutions requires effective communication and coordination with the other federal banking agencies. The FDIC engages in an ongoing process of proactively identifying risks to the deposit insurance funds and adjusting the risk-based deposit insurance premiums charged to the institutions.

Recent trends and events continue to pose risks to the funds. From January 1, 2002 to March 31, 2003, 11 banks and 1 thrift institution have failed and the potential exists for additional failures. While some



Symposium



Symposium



Offices of Inspector General Sponsor Second Emerging Issues Symposium

During the reporting period, the Offices of Inspector General of the Department of the Treasury, the Board of Governors of the Federal Reserve System, and the FDIC jointly sponsored a second Emerging Issues Symposium at the FDIC's Seidman Center. Again this year, the forum brought together a number of speakers who shared their perspectives on the banking and financial services industries and the challenges facing all who are involved in those arenas. Among the distinguished speakers were Vice Chairman Reich from the FDIC; John Hawke, Comptroller of the Currency; James Gilleran, Director of the Office of Thrift Supervision (OTS); and Rick Riccobono, Deputy Director, OTS. Additionally, staff representatives from the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Financial Services highlighted certain banking and financial services-related issues of congressional interest and the role the Inspector General community can play in addressing such issues. Other sessions included presentations by several of our FDIC colleagues on such topics as Emerging Risks to the Insurance Funds, Basel II, and Identity Theft; a session on Cyber Security by a representative from the General Accounting Office; a panel discussion by the Securities and Exchange Commission on Accounting Issues and Corporate Governance; a discussion of Trends in Financial Institution Crime, given by a Senior Trial Attorney from the Department of Justice; and a presentation by the Director of FinCEN. Participants at the symposium appreciated the opportunity to come together and hear such dynamic and enlightening discussion. Ideas presented during the symposium will serve to enhance the work of the Inspector General community and the value we can add to our respective agencies.

failures may be attributable primarily or in part to economic factors, bank mismanagement and fraud have also been factors in most recent failures. The environment in which financial institutions operate is evolving rapidly, particularly with the acceleration of interstate banking, new banking products and complex asset structures, and electronic banking. The industry's growing reliance on technologies, particularly the Internet, has changed the risk profile of banking. The consolidations that may occur among banks and securities firms, insurance companies, and other financial services providers resulting from the Gramm-Leach-Bliley Act pose additional risks to the FDIC's insurance funds. The Corporation's risk-focused examination process must operate to identify and mitigate these risks and their real or potential impact on financial institutions to preclude adverse consequences to the insurance funds.

Another risk to the insurance funds results from bank mergers that have created "megabanks," or "large banks" (defined as institutions with assets of over \$25 billion). For many of these institutions, the FDIC is the insurer but is not the primary federal regulator. Megabanks offering new or expanded services also present challenges to the FDIC. The failure of a megabank, for example, along with the potential closing of closely affiliated smaller institutions, could result in such losses to the deposit insurance funds as to require significant increases in premium assessments from an institution.

Further, because of bank mergers and acquisitions, many institutions hold both Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF) insured deposits, obscuring the difference between the funds. There has been ongoing consideration of merging the two insurance funds, with the thought being that the merged fund would not only be stronger and better diversified but would also eliminate the concern about a premium disparity between the BIF and the SAIF. Assessments in the merged fund would be based on the risk that institutions pose to the single fund. The prospect of different prices for identical deposit insurance coverage would be eliminated. Also, insured

institutions would no longer have to track their BIF and SAIF deposits separately, resulting in cost savings for the industry. The Corporation has worked hard to bring about deposit insurance reform and needs to continue to work with the banking community and the Congress in the interest of eventual passage of reform legislation. Shortly after the end of the reporting period, on April 2, 2003, the House of Representatives passed comprehensive deposit insurance reform by a vote of 411-11.

Another risk to the insurance funds relates to the designated reserve ratio. As of March 31, 2002, the BIF reserve ratio was at 1.23 percent, the first time it had fallen below 1.25 percent since 1995. By June 30, 2002, the BIF reserve ratio was at 1.26 percent, slightly above the statutorily mandated designated reserve ratio for the deposit insurance funds. As of December 31, 2002, the BIF ratio was at 1.27 percent. If the BIF ratio is below 1.25 percent, in accordance with the Federal Deposit Insurance Act (FDI Act), the FDIC Board of Directors must charge premiums to banks that are sufficient to restore the ratio to the designated reserve ratio within 1 year. The Corporation's challenge is to maintain or exceed the designated reserve ratio, as required by statute.

The process for setting deposit insurance premiums, which is closely related to the above discussion of the designated reserve ratio, represents yet another significant risk to the insurance funds. Insurance premiums are not generally assessed based on risk but rather the funding requirements of the insurance funds. This approach has the impact of assessing premiums during economic downturns when banks are failing and likely not in the best position to afford the premiums. Also, numerous "free rider" institutions have benefited from being able to sharply increase insured deposits without contributions to the insurance funds commensurate with this increased risk. This can occur because the designated reserve ratio has not been breached thereby triggering across-the-board premiums. Current deposit insurance reform proposals include provisions for risk-based premiums to be assessed on a more regularly scheduled basis than would occur using the existing

approach. Risk-based premiums can provide the ability to better match premiums charged to institutions with related risk to the insurance funds.

Material Loss Review of the Failure of the Connecticut Bank of Commerce, Stamford, Connecticut

During the reporting period, in accordance with Section 38(k) of the FDI Act, the OIG conducted a material loss review of the failure of the Connecticut Bank of Commerce (CBC), Stamford, Connecticut. Our audit objectives were to: (1) ascertain why the bank's failure resulted in a material loss to the insurance fund and (2) assess the FDIC's supervision of the bank, including implementation of the Prompt Corrective Action requirements of Section 38 of the FDI Act. CBC was closed on June 26, 2002. At the time of failure, CBC had total assets of approximately \$379 million. As of December 31, 2002, the FDIC estimated that the failure of CBC may ultimately cost the BIF \$63 million.

We reported that CBC failed and resulted in a material loss to the BIF because of ineffective corporate governance, including the external auditors' issuance of unqualified opinions on the bank's financial statements that briefly described but did not challenge the fair presentation and integrity of certain transactions and asset valuations. A major component of the \$63 million loss to the insurance fund resulted from the Chairman of the Board orchestrating nominee loan schemes. These nominee loans, which had outstanding balances of \$34 million when the bank was closed, had the effect of misleading bank regulators and CBC depositors as to the true financial condition of CBC, ultimately leading to CBC's insolvency and closure.

With respect to the supervision of CBC, FDIC and state examiners periodically conducted examinations, consistently identifying and reporting deficiencies, and taking various formal and informal enforcement actions. Further, the FDIC identified and investigated the complex loan schemes, which required substantial effort in order to determine the flow and ultimate recipient of funds. However, in retrospect, more aggressive supervisory action and additional scrutiny

of CBC's application to purchase MTB Bank—a New York state-chartered commercial bank—was warranted in light of CBC's:

- ☆ risky lending practices,
- ☆ failure to fully resolve examination findings and comply with enforcement actions, and
- ☆ questionable “satisfactory” Community Reinvestment Act (CRA) rating when the application was pending approval.

Finally, the FDIC implemented Prompt Corrective Action in accordance with the requirements of Section 38 of the FDI Act; however, Prompt Corrective Action was not fully effective due to improper asset valuations that had overstated CBC's capital for several years.

In summary, we recommended that the Director, Division of Supervision and Consumer Protection (DSC):

- (1) Include a provision in enforcement actions for certain troubled institutions, that the FDIC receive prior notice of material transactions, out-of-territory lending, or proposed new business activities and be afforded the opportunity to review and comment on same before the institution conducts such transactions or engages in such activities.
- (2) Revise the Case Managers Procedures Manual to ensure that bank management is fully assessed before approving applications for mergers and acquisitions.
- (3) Regarding capital injections in conjunction with an acquisition, merger, or change of control application, require: (a) acquirers to specify the source of funding in the application package and provide proof the funds are available and (b) DSC to review and validate the information submitted by acquirers prior to executing the transaction, and document resulting determinations.

- (4) Require field office examiners and regional office staff to fully document the rationale behind the decision-making process related to assigning CRA ratings that are based on special circumstances and not on a bank's actual CRA performance during the period under review.
- (5) Encourage examiners to work collaboratively with state examiners at resolving issues related to state banking laws, particularly when those issues directly affect the safety and soundness of an institution. This would include seeking advice from counsel.

DSC agreed to take action in response to our recommendations. DSC also provided comments regarding other aspects of the report. DSC noted that ineffective corporate governance resulted in excessive risk taking, disregard for laws and regulations, and questionable asset valuations—all of which exacerbated the potential loss to the FDIC. However, DSC disagreed with the OIG's conclusion that CBC failed and resulted in a material loss to the BIF because of ineffective corporate governance. It is DSC's position that “the proximate cause of CBC's failure was insider fraud in the form of nominee loans totaling at least \$34 million.” As discussed in the report, we agree that the nominee loan schemes were a key component of the material loss to the BIF and ultimately resulted in the bank's closure. However, in our opinion, the loan schemes were the proximate cause of the bank's closure, not the failure, which we believe is an important distinction. Assuming the FDIC receives nothing for the \$34 million in nominee loans, the magnitude of the loss indicates that other activities allowed to occur both before and after the nominee loans because of ineffective corporate governance significantly contributed to the demise of this bank and resulting material loss.

The Banking Commissioner for the State of Connecticut also provided comments to our draft report, stating that our review was “reasonably presented” and the recommendations “entirely appropriate.” The Commissioner also indicated that the State Banking Department has proposed legislation that, if

enacted, would address issues raised in this report pertaining to legal lending limits.

DSC Procedures for Addressing Deviations from Business Plans by Newly Established Banks

We issued a report on DSC's procedures for addressing deviations from business plans by newly established banks. The DSC Director requested this review and expressed concern that managers of some newly chartered banks were not adhering to the business plans approved by the FDIC during the new bank application process.

We concluded that the procedures used by FDIC case managers and examiners for evaluating and addressing new banks that have departed from initial business plan projections subsequent to their application for approval from the FDIC were adequate. Examiners were taking steps to review and assess a bank's adherence to its approved business plan and/or subsequent strategic plans and budgets.

Of added importance, we found that new banks, in effect, could be established through various regulatory and financial transactions that allow existing insured depository institutions to transfer their charters and insurance to new owners. When a new bank is created through the normal formation process, regulatory approval is sought through the application process for federal deposit insurance. However, other various transactions, including mergers, acquisitions, assumptions, and changes in control, are subject, by statute, to a less comprehensive application process because a new application for deposit insurance is not required.

Accordingly, we made two recommendations intended to enhance DSC's regulatory oversight in the application process for mergers, acquisitions, or changes in control and in the advance notification of changes in bank management. DSC management suggested an acceptable alternative action for one recommendation and concurred with the second recommendation.

In January 2003, the Corporation proposed a number of regulatory burden relief initiatives for the 108th Congress. Included among those were two that are consistent with recommendations we made in our report. These relate to proposed amendments to the

Bank Merger Act, Bank Holding Company Act, and Change in Bank Control Act.

OIG Issues Multiple Reports on FDIC Examiner Assessments of Risk Areas

We issued several reports this period that focused on examiners' assessments of specific activities that institutions engage in that can pose risks to the safety and soundness of the institutions and the insurance funds.

For example, our report on **Examiner Assessment of Commercial Real Estate Loans** presents the results of our review of examiner assessment of appraisals, cash flow, and loan policies at banks with high levels of commercial real estate loans. Historical analysis of the banking crisis of the 1980s reveals that many banks that failed during that time were active participants in the commercial real estate market.

We concluded that opportunities existed for improvement regarding examiner assessment of appraisals and cash flow. Specifically, examiners were not always using the lesser of acquisition cost or appraised value to assess loan-to-value ratios, were not updating old appraisal assumptions, and in some cases did not provide sufficient evidence that a cash flow analysis was performed. Moreover, we could not determine whether examiner review of loan policies was adequate in most cases due to the varying degrees in the way examiners documented their work.

The report contained six recommendations intended to improve the DSC's examinations of institutions with high levels of commercial real estate loans. DSC management concurred with one recommendation but did not concur with the remaining five recommendations, suggest acceptable alternative actions, or provide information that would convince us to revise any recommendations. DSC considers the concerns identified in the report as OIG-perceived documentation deficiencies. At issue is whether there is a correlation between the quality of the examination procedures supported by evidence in the working papers and the quality of the examinations themselves. It is our position that the two are inseparable. We requested DSC to reconsider its comments in light of our evaluation of them and provide a subsequent response.

DSC responded that planned examiner training programs and upcoming initiatives would address the outstanding recommendations. If these planned actions address the concerns covered by our recommendations, we may accept the results of this initiative as alternative actions to the recommendations.

Examiner Assessment of High Loan-Growth

Institutions: Another audit we conducted focused on examiner assessment of high loan-growth institutions. High loan growth is a high-risk indicator, and the FDIC's internal studies have shown that rapid loan growth has been identified repeatedly as a precursor to failure. We concluded that DSC examiners' loan review process for institutions that had experienced a significant level of loan growth was not sufficient in identifying risk. Specifically, examiners were not always:

- ★ targeting new loans for sampling purposes and reporting on the level of new loans reviewed,
- ★ assessing or commenting on the loan quality of newly originated loans, and
- ★ assessing the internal loan risk rating process at banks based on a methodology that incorporates a review of non-adversely classified loans.

As a result, there was insufficient assurance that examiners were consistently performing a comprehensive review and analysis of newly originated loans in high loan-growth institutions. Accordingly, the audit report contained six recommendations intended to improve DSC's regulatory oversight in the examination of high loan-growth institutions.

DSC questioned our assessments and conclusions based on its concerns with the scope of our audit. In addition, DSC management did not concur with these recommendations, suggest acceptable alternative actions, or provide information that would convince us to revise any recommendations. We requested DSC to reconsider its comments in light of our evaluation of them and provide a subsequent response.

DSC cited plans for a process improvement review that will focus on workshop documentation. DSC invited the OIG's input to that review. If the initiative addresses the concerns covered by our recommendations, we may accept the results of this initiative as alternative actions to the recommendations.

Subprime Lending: We completed an audit of DSC's assessment of subprime lending in the course of safety and soundness examinations. We conducted this audit because of concerns stemming from recent financial institution failures involving subprime lending activities. Subprime lending provides borrowers with a credit source that may not otherwise be available due to concerns with their credit history or repayment capacity. However, recent examinations revealed a number of financial institutions that were engaged in subprime lending activities without properly assessing or controlling the risks associated with this type of lending. As a result, many institutions have suffered losses, which in turn has jeopardized the overall financial health of those institutions.

Our audit determined that DSC has taken reasonable steps to ensure that institutions manage risks associated with subprime lending programs effectively. Specifically, the interagency policies and procedures for examinations of subprime banks provided examiners with the necessary guidance to identify and assess the condition of subprime loan programs in insured institutions and the examiners adequately implemented this guidance. FDIC examiners conducted pre-examination planning that included steps to look for indications of subprime programs and generally followed the interagency subprime examination procedures involving examinations of capital levels during onsite examinations. In addition, DSC maintains a quarterly database to assist in monitoring the condition of FDIC-insured institutions with subprime programs.

We did not make recommendations in our report, but we identified an issue that may warrant management's attention. Specifically, we noted that existing guidance may not be sufficient for ensuring that custom credit scoring models correctly predict the creditworthiness of borrowers. As a result, there is a potential for a lack

of consistency in onsite examinations of banks with subprime lending programs, particularly with regard to allowances for losses and capital level calculations. Also, in order for lenders to appropriately stratify the additional default risk and price the subprime products accordingly, constant monitoring and testing of credit scoring models is required to ensure that projected results are in line with actual performance.

Transactions with Affiliates: A bank's relationships and transactions with its affiliated organizations can significantly affect the operations and overall financial condition of a financial institution. As part of the safety and soundness examination of a bank, in situations where affiliated organizations are identified, DSC examiners determine whether a bank's transactions with its affiliates are in regulatory compliance and not detrimental to the safety and soundness of the financial institution. Material loss reviews and other reviews of several bank failures in recent years have identified concerns related to the failed financial institutions' relationships and transactions with their respective affiliates.

We conducted an evaluation to review DSC's efforts to identify affiliates of FDIC-supervised institutions and examine transactions with such affiliates and reported that DSC's efforts were generally adequate. DSC examiners relied on information requested of and provided by the financial institution and, in some cases, the Federal Reserve Board (FRB), to identify affiliates and affiliate transactions, assess the risks associated with affiliates and affiliate transactions, and establish an appropriate examination scope for affiliate activities. However, DSC examiners were not always requesting a list of affiliate transactions that had occurred since the prior examination or FRB reports regarding affiliate transactions and bank organizational structure.

We could not conclude on the adequacy of examination procedures applied to the financial institutions' affiliate activities for 4 of 21 financial institutions that we reviewed, because the examination procedures were not documented in the examination workpapers. DSC policies stipulate that examination documentation

should provide written support for the examination and verification procedures performed, conclusions reached, and narrative comments in the Report of Examination.

We recommended that DSC include a request for a list of affiliate transactions in the Safety and Soundness Examination Request Package when DSC knows or has reason to believe that a financial institution has affiliate activities and request that the bank provide the types or categories of affiliate transactions that have occurred since the previous examination and a list of transactions with values greater than a predetermined dollar threshold when affiliate transaction activity is voluminous. We also recommended that DSC inform examiners and case managers as to the availability of certain FRB Reports as additional resources for identifying affiliates and affiliate transactions. We further recommended that DSC ensure through several of its existing review programs that examiners follow DSC's policies for documenting affiliate work and the examination procedures used, documents relied upon, and analyses conducted in the examination of transactions with affiliates.

DSC's proposed actions in response to our report met the intent of our recommendations.

FDIC Examiner Use of Work Performed by Independent Public Accountants

As discussed earlier, the work performed by Independent Public Accountants (IPA) who are engaged by FDIC-supervised financial institutions has elicited increased attention in light of the types of corporate accounting scandals that have occurred in other business areas recently. During the reporting period, we evaluated FDIC examiner use of the work performed by IPAs who are engaged by FDIC-supervised financial institutions.

We determined that FDIC examiners and case managers made reasonable use of the work performed by IPAs by considering IPA reports, management letters, and other available documentation in conjunction with their safety and soundness examinations and in devising the overall supervisory strategy. FDIC examiners expanded their examination testing and review when

an IPA uncovered or reported irregularities or problems in an area, and the examiners followed up on the institution's corrective actions. Examiners also effectively resolved differences with IPAs. In addition to the above, for those institutions with examination ratings of 4 or 5, indicating problem areas, examiners also reviewed the IPA's workpapers, thoroughly documenting their review. FDIC examiners reviewed IPA workpapers to gain an understanding of the IPA's scope and results of work performed including, for example, in the areas of internal control, the risk of material misstatement due to fraud, or asset valuation concerns.

Our report did not contain recommendations. DSC's response to our report indicated that the division would continue to be proactive in addressing its evaluations of external audit activity through its own efforts and through interagency initiatives.

The Division of Supervision and Consumer Protection's Reporting on Issues Related to Problem Banks

The FDIC's Board of Directors needs reliable and timely information related to the safety and soundness of FDIC-insured institutions in order to carry out its Board responsibilities to the Corporation. We undertook an audit to determine the extent and type of information that DSC reported to the FDIC Board of Directors on problem banks. During this audit, we reviewed the reporting process including, but not limited to, the type, sources, frequency, consistency, and distribution of information reported on problem banks, undercapitalized institutions, and Section 38 actions.

We concluded that DSC issues a significant number and variety of reports and maintains folders in Microsoft Outlook to keep the FDIC Board of Directors informed of material supervisory, policy, and administrative issues. These reports and folders include information on financial institutions that DSC classifies as "problem banks" and provide narrative information on the institutions' financial condition. DSC also provides information on other banks that present heightened risk to the deposit insurance funds. However, we reported that DSC could more efficiently and effectively

report problem bank information and better secure bank information that it maintains in Outlook folders.

We recommended that the Director, DSC, take actions to assess report recipients' needs and consider consolidating, eliminating, or automating certain reports generated by DSC regional offices; clarify the distinction between its various problem institution lists and other reports on problem institutions; ensure that regional offices report consistently all undercapitalized institutions and Section 38 provisions for all FDIC-insured financial institutions; and revalidate who has access to automated information and ensure that all confidential and sensitive bank data are secured.

DSC management concurred with five of our six recommendations and stated that it had taken steps to address the other recommendation. We consider all recommendations to be resolved.

Effectiveness of Resolution and Receivership Activities

One of the FDIC's most important corporate responsibilities is planning and efficiently handling the franchise marketing of failing FDIC-insured institutions and providing prompt, responsive, and efficient resolution of failed financial institutions. These activities maintain confidence and stability in our financial system. The Division of Resolutions and Receiverships (DRR) has outlined primary goals for the following four business lines and each is accompanied by significant challenges.

- (1) *Deposit Insurance.* DRR must provide customers of failed financial institutions with timely access to their insured funds and financial services. A significant challenge in this area is to ensure that FDIC deposit insurance claims and payment processes are prepared to handle large institution failures.
- (2) *Resolutions.* As DRR seeks to resolve failed institutions in the least costly manner, its challenges include improving the efficiency of

contingency planning for institution failures and improving internal FDIC communication and coordination as well as communication with the other primary federal regulators to ensure timely access to records and optimal resolution strategies.

- (3) *Receivership Management, Accounting, Internal Review, and Customer Service.* DRR's goal is to manage receiverships to maximize net return towards an orderly and timely termination and provide customers of failed institutions and the public with timely and responsive information. Related challenges include improving the efficiency of the receivership termination process, improving claims processing, continual assessment of recovery strategies, improving investigative activities, and charging receiverships for services performed under the Receivership Management Program (i.e., service costing).
- (4) *Employees.* DRR employees need to possess the resources, skills, and tools to perform the mission of the Division. One related challenge is to ensure that Division personnel have sufficient legal support for decision making.

Evaluation of the FDIC's Corporate Readiness Plan

The Corporate Readiness Plan (CRP) is DRR's contingency plan for responding to a series of institution failures exceeding DRR's capacity to address with its own resources. We evaluated the reasonableness of the CRP during the reporting period. We focused on key Plan elements and underlying assumptions. We concluded that the CRP is reasonable and provides sufficient flexibility for the FDIC to handle a relatively wide range of institution failures without causing significant disruption to other aspects of the Corporation's mission.

OIG Work Addresses Continuing Interest in Privacy

We issued a report on the FDIC's control over the use and protection of social security numbers (SSN). We conducted our work in response to congressional interest regarding the widespread sharing of personal information and occurrences of identity theft. The FDIC OIG along with other Offices of Inspector General performed reviews on behalf of the President's Council on Integrity and Efficiency. We limited our review to the FDIC Division of Resolutions and Receiverships' (DRR) use and protection of SSNs during the marketing of failing financial institutions, marketing of assets from failed financial institutions, and bid process.

We concluded that the FDIC's control over the use and protection of SSNs was not fully adequate. Specifically, SSN and other personal information was made readily available over several Web sites used in marketing and selling the remaining assets from failed financial institutions to parties external to the FDIC that were not subject to a pre-approval process or access control. Moreover, FDIC contractors were given access to SSN fields so they could carry out system maintenance responsibilities on several internal FDIC systems, and their access to and use of such data was not adequately controlled and monitored.

Our report contained four recommendations intended to improve DRR's handling of SSNs and other sensitive data. DRR agreed to take action in response to all four recommendations in our report.

The Division of Resolutions and Receiverships' Controls Over Data Input to the Service Costing System

As referenced previously, the FDIC uses the Service Costing System to bill FDIC receiverships for services performed by the Corporation on behalf of the receiverships. In a report issued during the reporting period, we presented the results of our assessment of whether adequate controls existed to ensure the

accuracy, timeliness, and completeness of DRR data used by the Service Costing System. We limited our review to the controls related to data submissions from DRR systems to the Service Costing System that are used by the Division of Finance (DOF) to calculate receivership billings.

We concluded that DRR controls to ensure the timeliness of data provided to the Service Costing System were adequate; however, controls to ensure the accuracy and completeness of data used by the Service Costing System could be improved. Specifically,

- ☆ DRR had not instituted sufficient controls to adequately validate and verify data in systems that update the Service Costing System. As a result, the FDIC did not have adequate assurance that workload data from DRR systems were valid and, therefore, that expenses were accurately charged to receiverships under the Service Costing System.
- ☆ DRR's procedures for ensuring accurate and complete data processing and reporting to the Service Costing System were not adequate. As a result, approximately \$1.01 million in additional corporate expenses were not properly billed to receiverships during 2002. A portion of these expenses would not likely be recovered by the FDIC from receivership dividend payments.

The FDIC has implemented the Service Costing System as a means to comply with applicable laws and regulations related to appropriately billing expenses to receiverships. However, the FDIC had not achieved full compliance because procedures for ensuring complete data processing and reporting to the Service Costing System were not adequate. In its dual role as insurer and receiver, the Corporation should avoid even the appearance of an inequitable distribution of expenses between the Corporation and receiverships. The data completeness control deficiencies we identified limited the Corporation's ability to avoid such an appearance and ensure compliance with applicable laws and regulations.

We made a total of seven recommendations that were intended to enhance the accuracy, timeliness, and completeness of the data used in the Service Costing System. The Directors of DRR and DOF concurred with the recommendations.

Management and Security of Information Technology Resources

Information technology (IT) continues to play an increasingly greater role in every aspect of the FDIC mission. As corporate employees carry out the FDIC's principal business lines of insuring deposits, examining and supervising financial institutions, and managing receiverships, they rely on information and corresponding technology as an essential resource. Information and analysis on banking, financial services, and the economy form the basis for the development of public policies and promote public understanding and confidence in the nation's financial system. IT is a critical resource that must be safeguarded.

Accomplishing IT goals efficiently and effectively requires sound IT planning and investment control processes. The Corporation's 2003 IT budget is approximately \$171.9 million. The Corporation must constantly evaluate technological advances to ensure that its operations continue to be efficient and cost-effective and that it is properly positioned to carry out its mission. While doing so, the Corporation must continue to respond to the impact of laws and regulations on its operations. Management of IT resources and IT security have been the focus of several laws, such as the Paperwork Reduction Act, the Government Information Security Reform Act (GISRA), and most recently, the Federal Information Security Management Act of 2002 (FISMA). Similar to the requirements of GISRA, under FISMA, each agency is required to report on the adequacy and effectiveness of information security policies, procedures, and practices and compliance with information security requirements of FISMA.

The Corporation has worked to implement many sound information system security controls but has not yet fully integrated these into an entity-wide program. Additionally, efforts to identify sensitive data, plan for and fund essential security measures, incorporate security requirements in FDIC contracts, enhance software configuration management, and measure the overall performance of the information security program need continued attention. Frequently, security improvements at the FDIC were the result of a reaction to specific audit and review findings, rather than the result of a comprehensive program that provided continuous and proactive identification, correction, and prevention of security problems. As reiterated in the Inspector General's opening statement to this semiannual report, the Corporation is working to appoint a permanent Chief Information Officer (vacant since September 2001) to strengthen accountability and authority in the FDIC's information security program and to ensure that other key positions in the Division of Information Resources Management are filled permanently.

The FDIC's progress in addressing the security weaknesses identified in our 2001 Security Act evaluation report were offset by the emergence of new information security weaknesses identified during our 2002 evaluation, as well as the FDIC's internal evaluation completed on January 10, 2003. Thus, management and security of IT resources continue to warrant management attention. For its part, the OIG is in the process of reviewing these issues as part of our FISMA-related work for 2003.

Integration of Information Security into the Capital Planning and Investment Control Process

The OIG and Office of Internal Control Management conducted a joint review to evaluate the FDIC's progress in integrating information security into the capital planning and investment control process (CPICP) since the OIG's first GISRA report was issued in September 2001. That report identified CPICP as an area that may warrant reporting as an individual material weakness. Our objective was to evaluate the extent to which the FDIC integrates security into that process.

We determined that the FDIC was continuing efforts to improve its overall IT capital planning process, but more progress was needed. The FDIC had not fully established or implemented the three management controls associated with the CPICP related to security, i.e., an enterprise architecture that specifically addresses security requirements, consideration of information security in capital IT investment decisions, and system life cycle security management. Although the Corporation was progressing, until these key management controls are fully established and implemented, corporate level decision makers cannot be assured that security is appropriately integrated in FDIC systems commensurate with the level of risk associated with those systems. Furthermore, while this report focused on the integration of information security in the FDIC's CPICP, the overall importance of establishing and fully implementing the enterprise architecture cannot be overlooked. An enterprise architecture must be in place before investment decisions can be made in a structured way.

The Acting Chief Information Officer, CFO, and Chief Operating Officer provided a written response to our report indicating their concurrence with all six of the recommendations in the report. They subsequently provided specific actions and milestones for the six recommendations. We are continuing to monitor the Corporation's implementation of the corrective actions in response to this review and will also re-address the issues identified in our upcoming FISMA work.

Phase II Network Operations Vulnerability Assessment

PricewaterhouseCoopers Consulting (PwC), an independent professional services firm, was engaged by the OIG to perform a vulnerability assessment of the FDIC's network operations. The FDIC has invested heavily in defending its network perimeter by implementing preventive and detective controls. The implementation of firewalls, zoning of Internet facing servers, and monitoring of scans against these servers by the FDIC contributes to a more secure external perimeter. PwC's testing confirmed that these controls were operating effectively. PwC's external testing did identify one high-risk and one moderate vulnerability,

in response to which the Corporation took action. Except for the two noted instances, PwC reported that the FDIC's network perimeter defenses were effective.

PwC identified other areas for improvement and recommended a number of actions to strengthen the FDIC's internal network controls. The Corporation committed to take action to address the concerns raised by PwC.

Assessment of Corporate Performance

The Government Performance and Results Act (Results Act) of 1993 was enacted to improve the efficiency, effectiveness, and accountability of federal programs by establishing a system for setting goals, measuring performance, and reporting on accomplishments. The Results Act requires most federal agencies, including the FDIC, to prepare a strategic plan that broadly defines each agency's mission, vision, and strategic goals and objectives; an annual performance plan that translates the vision and goals of the strategic plan into measurable annual goals; and an annual performance report that compares actual results against planned goals.

The Corporation's strategic plan and annual performance plan lay out the agency's mission and vision and articulate goals and objectives for the FDIC's three major program areas of Insurance, Supervision, and Receivership Management. The plans focus on four strategic goals that define desired outcomes identified for each program area: (1) Insured Depositors Are Protected from Loss Without Recourse to Taxpayer Funding, (2) FDIC-Supervised Institutions Are Safe and Sound, (3) Consumers' Rights Are Protected and FDIC-Supervised Institutions Invest in Their Communities, and (4) Recovery to Creditors of Receiverships Is Achieved. Through its annual performance report, the FDIC is accountable for reporting actual performance and achieving these strategic goals.

The Corporation has made significant progress in implementing the Results Act and needs to continue to address the challenges of developing more outcome-

oriented performance measures, linking performance goals and budgetary resources, implementing processes to verify and validate reported performance data, and addressing crosscutting issues and programs that affect other federal financial institution regulatory agencies.

OIG Reviews FDIC 2003 Annual Performance Plan and 2002 Annual Report

During this reporting period, the OIG reviewed and provided advisory comments to management on the FDIC's draft 2003 Annual Performance Plan and 2002 Annual Report. The purpose of our reviews was to provide suggestions for enhancing the Corporation's performance plan and annual report based on our knowledge and work related to the Results Act. In addition, we reviewed the plan and report to determine whether they were in compliance with the Results Act and related Office of Management and Budget guidance. We also provided an OIG "Comfort Letter" on the Management Controls Section of the Corporation's Annual Report.

- ☆ **Advisory Comments on 2003 Annual Performance Plan.** The OIG acknowledged the Corporation's continuing efforts to improve the plan each year and offered several suggestions for management's consideration. These included (1) considering adding specific annual performance goals for the most significant corporate resource management initiatives, especially those related to human capital and the other priorities in the President's Management Agenda; (2) considering including specific performance goals to address the most significant management and performance challenges facing the Corporation, as identified by the OIG, including FDIC information security and the quality of bank financial reporting and auditing; (3) considering approaches to better integrate the separate Corporate Performance Objectives process into the Results Act annual goal-setting process so that there is a clearer linkage between the two processes; and (4) considering an additional receivership termination performance measure for pre-2000 receiverships.

☆ **Advisory Comments on 2002 Annual Report.**

The OIG recognized and commended the Corporation's substantial effort and accomplishment in preparing the FDIC's first consolidated annual report, which integrates the Chief Financial Officers Act Report, the Program Performance Report, and the traditional Annual Report. The Corporation met its target to complete its report by March 31, 2003, thus achieving the goal of issuing the report within 90 days of the reporting period ending December 31, 2002. This initiative represents a significant step in improved corporate accountability and reporting.

As discussed in the *Adequacy of Corporate Governance in Insured Depository Institutions* write-up of this section, we reviewed the Corporation's draft consolidated report and suggested that the report include a discussion of the risks associated with bank corporate governance (including the quality of bank financial reporting and auditing) and the challenges of Sarbanes-Oxley Act implementation. In consideration of our suggestion, the Corporation included a brief discussion of corporate governance (see page 11).

☆ **Inspector General Comfort Letter on Management Control Section of 2002 Annual Report.** We reviewed FDIC's Internal Control and Risk Management Program, including its annual evaluation and reporting process, and concluded that the process provides a reasonable basis for management's positive conclusion on internal controls. Additionally, we concluded that the process was consistent with the requirements of the Federal Managers' Financial Integrity Act as mandated by the Chief Financial Officers Act. We identified no material or significant weaknesses in the Corporation's 2002 Internal Control and Risk Management Program. Our report acknowledged the Corporation's continuing positive actions with respect to management of the Internal Control and Risk Management Program.

During 2002, the Corporation established a desk officers program to enhance its management and monitoring of the Internal Control and Risk Management Program. As part of the desk officers program, individual analysts are designated as points of contact for both advising certain divisions or offices on program-related issues and for monitoring program compliance. Each division and office now consults one analyst having detailed knowledge of its operations and its implementation of the Internal Control and Risk Management Program.

As noted in our advisory comments on the Annual Report and our Comfort Letter, the appendix of the FDIC Consolidated 2002 Annual Report includes a brief description of the OIG's views of the most significant management and performance challenges facing the FDIC. Including OIG views is a positive step in full accountability and is consistent with the Reports Consolidation Act of 2000. The annual report notes that management is committed to addressing these issues identified by the OIG.

The OIG will continue to help ensure that the FDIC's Results Act-related efforts fully conform to the spirit and intent of the Act. We plan to continue to work with the Corporation to improve the FDIC's performance measurement and reporting. In this process, we will give particular attention to various methodologies for assessing performance, including the implications and relevance of the President's Management Agenda and the Office of Management and Budget's Program Assessment Rating Tool. The OIG will also continue to monitor and review legislation proposed in the Congress to amend the Results Act and will actively participate to refine appropriate OIG Results Act roles, responsibilities, and activities through the President's Council on Integrity and Efficiency and the interagency groups it sponsors.

Transition to a New Financial Environment

On September 30, 2002, the FDIC executed a multi-year contract to replace its core financial systems and applications with a commercial-off-the-shelf software package. The FDIC Board had previously approved contract expenditure authority for the New Financial Environment (NFE) project totaling approximately \$28.8 million. At the time the Board case was approved, the FDIC estimated the total life cycle cost of NFE, including FDIC staff time, to be approximately \$62.5 million over 8 years. NFE is a major corporate initiative to enhance the FDIC's ability to meet current and future financial management and information needs.

Although NFE offers the FDIC significant benefits, it also presents significant challenges. These challenges will test the Corporation's ability to (1) maintain unqualified opinions on the FDIC's annual financial statements through the system implementation and associated business process reengineering; (2) manage contractor resources, schedules, and costs; and (3) coordinate with planned and ongoing system development projects related to NFE.

Overall, the FDIC needs to ensure that the NFE Project team successfully implements modern and reliable systems to improve financial business processes and support current and future financial management and information needs, while controlling costs for the new environment to the maximum extent possible.

Audits of the New Financial Environment Project

Two reviews that we completed during the reporting period related to the NFE project. The first was an agreed-upon procedures to review and comment on certain procedures and documentation related to the solicitation for a commercial off-the-shelf software solution and associated system development life cycle services (i.e., a "new financial environment") to replace the Corporation's current financial management system. We provided our results to the Division of Administration for its use.

We also completed an audit of the FDIC's NFE project control framework. This audit was the first in a series of reviews that we intend to conduct at critical milestones or decision points during the development and implementation of the NFE. We concluded that the FDIC had established key controls for ensuring the delivery of a quality system that meets corporate requirements and user needs in a timely and cost-effective manner. However, we identified opportunities for the FDIC to better integrate key NFE project controls, strengthen project communications, and improve risk response planning on the project.

We recommended that the DOF and the NFE project team: develop and approve a charter for the NFE Steering Committee that defines its responsibilities, membership, and operating guidelines; document an integrated control framework that explains, at a minimum, the roles, relationships, and reporting structures among key project players on the NFE project; promptly complete and approve a formal communications management plan; consult with the NFE risk manager and the contractor involved to establish clear measures for determining when project risks classified as significant occur or are about to occur; and develop contingency plans, as appropriate, for risk factors categorized as significant before they become a reality. The Director, DOF agreed to take action in response to all recommendations.

Organizational Leadership and Management of Human Capital

The FDIC has been in a downsizing mode for the past 10 years as the workload from the banking and thrift crises of the late 1980s and 1990s has been accomplished. Over the past months, a number of division mergers and reorganizations took place and the Corporation concluded its 2002 buyout/retirement incentive programs. These most recent incentive programs achieved a reduction of 699 staff and \$80 million projected savings in future operating costs. Additional downsizing efforts are ongoing. In total, over the past 10+ years, the workforce (combined from the FDIC and the Resolution Trust Corporation) has fallen from

approximately 23,000 in 1992 to approximately 5,400 as of March 31, 2003.

By July 2003, the Corporation hopes to substantially complete required downsizing, identify an appropriate skills mix, and correct any existing skills imbalances. To do so, the Corporation continues to carry out other features of its comprehensive program such as solicitations of interest, reassignments, retraining, outplacement assistance, and possible reductions-in-force. The Corporation has also predicted that almost 20 percent of FDIC employees will be eligible to retire within the next several years. As the Corporation adjusts to a smaller workforce, it must continue to ensure the readiness of its staff to carry out the corporate mission.

The Corporation must also work to fill key vacancies in a timely manner, engage in careful succession planning, and continue to conserve and replenish the institutional knowledge and expertise that has guided the organization over the past years. A need for additional outsourcing may arise and hiring and retaining new talent will be important. Hiring and retention policies that are fair and inclusive must remain a significant component of the corporate diversity plan. Designing, implementing, and maintaining effective human capital strategies are critical priorities and must be the focus of centralized, sustained corporate attention.

A significant element of this performance and management challenge relates to organizational leadership at the FDIC Board of Directors level, specifically with respect to the current make-up of the Board. The Board is a body whose strong leadership is vital to the success of the agency and to the banking and financial services industry. The Board is comprised of five directors, including the FDIC Chairman, two other FDIC directors, the Comptroller of the Currency, and the Director of the Office of Thrift Supervision. In order to ensure that the balance between various interests implicit in the Board's structure is preserved, the Board should operate at full strength. However, the Board has been operating with an FDIC Director vacancy since September 1998. Accordingly, we have urged that vacancies on the Board be filled as promptly as

practicable in order to afford the FDIC the balanced governance and sustained leadership essential to the agency's continued success. Again in the Inspector General's opening statement to this semiannual report, concern over the Board vacancy is expressed.

Cost Containment and Procurement Integrity

As steward for the Bank Insurance Fund and Savings Association Insurance Fund, the FDIC seeks ways to limit the use of those funds. As such, the Corporation must continue to identify and implement measures to contain and reduce costs, either through more careful spending or assessing and making changes in business processes to increase efficiency. Many of the efforts described above as part of other management and performance challenges (e.g., New Financial Environment, service costing, corporate downsizing) attest to the Corporation's ongoing efforts to do so.

A key challenge to containing costs relates to the contracting area. To assist the Corporation in accomplishing its mission, contractors provide services in such areas as information technology, legal matters, loan servicing, and asset management. To achieve success in this area, the FDIC must ensure that its acquisition framework—that is, its policies, procedures, and internal controls—is marked by sound planning; consistent use of competition; fairness; well-structured contracts designed to produce cost-effective, quality performance from contractors; and vigilant contract management and oversight.

The Corporation has taken a number of steps to strengthen internal control and effective oversight. However, our work in this area continues to show that further improvements are necessary to reduce risks such as the consideration of contractor security in acquisition planning, incorporation of information security requirements in FDIC contracts, and oversight of contractor security practices. Other risks include corporate receipt of billings for such items as unauthorized subcontractors, unallowable subcontractor markups, incorrect timesheets, unreasonable project

management hours billed, conflicts of interest, and unauthorized labor categories. The combination of increased reliance on contractor support and continuing reductions in the FDIC workforce presents a considerable risk to the effectiveness of contractor oversight activities. Additionally, large-scale procurements, such as Virginia Square II (a \$111 million construction project to house FDIC staff for the most part now working in leased space in the District of Columbia) and the New Financial Environment, necessitate continued emphasis on contractor oversight activities.

The Corporation's Procurement Credit Card Program

We conducted a review of the FDIC's procurement credit card program during the reporting period, largely in response to congressional interest on the part of Senator Charles Grassley. We found that the FDIC's

OIG Responds to Congressional Inquiry from Senator Mikulski

During the reporting period the OIG responded to a letter from Senator Barbara A. Mikulski dated July 26, 2002. In that letter, Senator Mikulski requested that the OIG review allegations made by FDIC employees that the FDIC had presented incorrect information to the Congress regarding its plans to outsource mainframe production control and computer operations (Data Center) positions. In response, we undertook a review to determine whether the information that the FDIC provided to the Congress was adequately supported. To perform our analysis, we grouped the statements that the FDIC had made to the Congress into four areas: (1) the FDIC's downsizing and 2002 buyout program, (2) the cost benefit analysis performed to determine the cost effectiveness of outsourcing, (3) the independent arbitrator's decision, and (4) the contractor selection. We then examined the FDIC's support for each of these areas. We communicated our results in a letter to Senator Mikulski, concluding that the information that the FDIC had provided to the Congress was adequately supported.

internal control over its procurement credit card program was not fully effective. In line with the U.S. General Accounting Office's (GAO) standards for internal control, the FDIC took action to foster an environment for proper use of procurement cards by establishing and communicating formal policies, procedures, and approval processes to reduce the risk of improper use of the card. However, we determined that FDIC employees were not always fully complying with established policies, procedures, and control activities, and in some cases the policies and procedures needed reinforcement, modification, or clarification. It is important to note that individual deficiencies were not material; however, collectively, they represented systemic weaknesses that increased the risk of misuse.

In some cases, procurement credit cards and numbers were not properly safeguarded, employees were able to circumvent purchase limits, some purchases lacked supporting documentation, and employees at times incurred sales taxes although the FDIC Acquisition Policy Manual specifically instructs cardholders to attempt to avoid paying these charges. We found that, in the absence of clear policies and procedures, at times extravagant meals were purchased with procurement credit cards, as well as other purchases that may not qualify as "official business." Finally, FDIC policies did not restrict alcoholic beverage purchases with the cards.

With respect to monitoring and overseeing the effectiveness of the procurement card program, the FDIC did not have effective procedures for canceling the cards for employees departing the FDIC, and in several cases, former employees continued to have credit card privileges even after their departure from the Corporation. In addition, the FDIC did not perform routine analyses to determine whether cardholders were using the procurement credit card and had a business need for the card. Some employees in our sample were issued cards but rarely used them, increasing the risk of misuse or undetected loss of the procurement credit card. Procurement cardholders in some cases had spending limits that exceeded their normal purchase activity, and limits were not reviewed to ensure they reflected the

extent of spending that users were likely to incur. As a result, the FDIC procurement credit card program was more vulnerable to fraud and misuse.

Finally, the Corporation had not conducted a formal risk analysis, another suggested component of GAO's standards for internal control, to identify specific types of vulnerabilities and steps to address them.

Our report contained eight recommendations intended to improve the Division of Administration's controls over the procurement credit card program. Actions are currently ongoing or planned to address all of our concerns.

Review of FFIEC Call Report Modernization Cost Benefit Analysis

At the request of several Corporation senior managers, the OIG completed a review of the cost benefit analysis (CBA) and assumptions supporting the draft request to the FDIC's Board of Directors for funding the Federal Financial Institutions Examination Council (FFIEC) Call Report Processing Central Data Repository, dated January 23, 2003. The Task Force on Reports and Call Modernization Steering Committee requested approval of \$44 million for a 10-year, multi-phased contract to be awarded on behalf of the FDIC, Federal Reserve Board, and Office of the Comptroller of the Currency to build and operate a shared facility for managing data collected under the federal bank regulatory requirements.

The Institution Data Management project team prepared the CBA on behalf of the Call Modernization Steering Committee of the FFIEC Task Force on Reports. The CBA compared two alternatives on the basis of cost, benefit, risk, and sensitivity.

We concluded that the methodology used in comparing the alternatives was generally consistent with FDIC and Office of Management and Budget guidance for the preparation of a CBA. The Institution Data Management project team obtained and analyzed cost data from several divisions, analyzed the benefits and risks associated with the alternatives, and projected the impact that the cost benefit assumptions could have on the recommended alternative in the sensitivity analysis. However,

some of the assumptions and the rationale used to arrive at the amounts included in the cost analysis were not consistently supported or clearly explained. The sensitivity analysis included in the CBA compensated for the risks associated with this weakness.

We suggested that the FDIC consider ensuring that assumptions made in preparing a CBA are fully documented to facilitate the post implementation review of benefits and costs, and requiring each division impacted by alternatives in a CBA review to concur or non-concur with its contents to establish accountability. Any non-concurrence from an impacted party should also be discussed in the CBA. The CFO and Chief Operating Officer agreed to take action in response to these suggestions.

OIG Issues Report on FDIC Travel, Relocation, and State Income Tax Withholding Policies and Procedures

We completed an audit of selected FDIC travel, relocation, and state income tax withholding policies and procedures and issued our final report during the reporting period. We conducted the review in response to allegations made by a former FDIC employee. The objective of this audit was to determine whether the FDIC had adequately designed and implemented policies and procedures in specific travel, relocation, and state withholding tax areas where allegations had been made.

We concluded that the FDIC had designed or implemented policies and procedures for most of the operational areas addressed in the allegations. However, additional actions were necessary to enhance certain policies and procedures and remedy prior errors in the following areas: (1) employee spouses' travel, (2) employee personal weekend return trips home while on extended official travel, (3) determination of employee residency for state withholding tax purposes, and (4) certain transactions subject to Title 5 salary cap limitations.

We made seven recommendations to address the issues we identified. The Director of DOF and the Division of Administration (DOA) provided a joint written

response to the draft report. DOF and DOA concurred with our findings, and corrective actions have been taken or are planned in response.

The OIG's Post- and Preaward Contract Reviews

With respect to procurement integrity-related reports, we issued four post-award contract audits and two preaward reviews during the reporting period. The objectives of the post-award audits are to determine whether amounts charged to FDIC contracts are allowable, allocable, and reasonable. Preaward reviews focus on the bids received from potential contractors. We can also review the contract award process and contractor controls, as needed.

We reported a total of \$1.22 million in monetary benefits as a result of the post-award audits. Management agreed with \$20,500 of that amount, disagreed with \$106,896, and management decisions were pending for the remainder of the total amount identified as monetary benefits.

As for the preaward reviews, one related to the New Financial Environment referenced previously, and the other to the Virginia Square Phase II Project general contractor.

Agreed Upon Procedures for the Government-wide Financial Statements

We completed agreed-upon procedures to assist the Department of the Treasury and the GAO in evaluating the FDIC's assertion that the Corporation reconciled intragovernmental activity and balances as of and for the fiscal year ended September 30, 2002 with its trading partners (i.e., other federal government entities with whom the FDIC conducts business activities, such as the U.S. Treasury). We also applied the agreed-upon procedures to evaluate the FDIC's assertion that it compared amounts in the government-wide standard general ledger to the general ledger balances in its financial management system. We found no material differences between amounts in the Corporation's financial records and those contained in either the trading partners' balances or the government-wide standard general ledger.

OIG Efforts Support GAO Financial Statement Audit Work

OIG staff assisted the U.S. General Accounting Office (GAO) by conducting work on two specific audit areas related to the FDIC's financial statement audit: the Receivables from Bank/Thrift Resolutions and Receivership Receipts. To meet accelerated reporting deadlines established by the Corporation, the OIG committed additional resources to determine whether the FDIC had implemented effective internal controls over (1) financial reporting of receivables from failed insured depository institutions and (2) recoveries from the liquidation of failed insured depository institution assets. We provided our results to the GAO for its consideration in evaluating the Corporation's internal control over financial reporting and compliance with applicable laws and regulations.

Additionally, the OIG provided information technology support to the GAO as it conducted the overall financial statement audit. Throughout the year, we provided statistical expertise and conducted cyclic sample selections from corporate payroll, accounts payable, accounts receivable, and allocation activities. We also conducted data integrity evaluations, program code analysis, and file security reviews of corporate systems.

Finally, we assisted the GAO in its wrap-up of the audit fieldwork by conducting automated year-end reconciliations of payroll, accounts payable, and travel. We also automated the account grouping process to facilitate consolidation and verification of the financial accounts into the insurance funds' balance and income statements.

Update

Recovery of Abandoned Assets and Unclaimed Deposits

The FDIC recently honored the Division of Resolutions and Receiverships' Bank Account Control Unit (BACU) with the Chairman's Excellence Award for its efforts related to the recovery of abandoned assets and unclaimed deposits. The OIG joins the FDIC in its recognition and believes BACU's successful recovery of abandoned assets and implementation of steps to reconcile and recover unclaimed deposits are directly related to prior OIG reports. In August 1999, the OIG issued a report to the FDIC entitled *Audit of Abandoned Assets Held by States' Unclaimed Property Agencies* (Audit Report No. A99-038) in which the OIG reported on unclaimed property agencies that were holding millions of dollars in assets belonging to the FDIC and its receiverships. The OIG recommended that the FDIC take appropriate actions to remove assets held by states' unclaimed property agencies from its finders fee program that the Division of Resolutions and Receiverships operated and make the Division of Finance responsible for recovering those assets. In addition, the OIG shared its methodologies for identifying unclaimed assets in the state unclaimed property databases with FDIC representatives. As a result, as of May 2001, BACU had recovered about \$5.3 million dollars and avoided paying finders fees to private individuals and firms for those assets. Further, in recovering those assets, the BACU had established contacts at state unclaimed property agencies that later helped facilitate monitoring FDIC and state-reported unclaimed deposits.

As a followup to our audit on abandoned assets, the OIG issued a report entitled *The FDIC's Identification of and Accounting for Unclaimed Deposits Transferred to State Unclaimed Property Agencies* (Audit Report No. 01-024). The unclaimed deposits amendments (UDA) to the Federal Deposit Insurance Act contain procedures for owners of unclaimed deposits to file deposit claims against failed financial institutions. UDA provides requirements that affect the manner and time period within which owners of unclaimed deposits may obtain funds from the FDIC, institutions that acquired failed financial institutions, and state unclaimed property agencies. We reported on differences between FDIC and state unclaimed property agencies' totals for accounts related to the UDA, the need to reconcile those differences and monitor those accounts before the 10-year periods during which states should try to locate owners of those deposits began to expire, and the need for an automated system to account for unclaimed deposits transferred to state unclaimed property agencies.

Since issuance of our report, BACU has taken the lead in converting thousands of accounts related to the UDA from seven different data bases to a new system of record—the Dividend Processing System—and implemented outreach processes with other entities, such as the National Association of State Treasurers and Unclaimed Property Administrators to help enhance a smooth recovery of funds escheated and potentially due back to the FDIC. BACU's preliminary estimates of potential recoveries of unclaimed deposits are between \$10 million and \$20 million from accounts escheated under the UDA process.

In summary, formed in 1996, BACU started the recovery of abandoned funds in November 1999 and, since that time, has recovered a total of about \$9.5 million, as of December 31, 2002. During 2002, over 4,000 claims were filed with holding entities and 3,500 recoveries were realized, resulting in \$3.5 million in recoveries in 2002 alone. Those claims were based on extensive research using innovative techniques and various sources.

BACU's efforts are deserving of recognition, and the OIG endorses continued attention to recovering unclaimed assets and deposits for the FDIC.



Investigations

Investigative Statistics October 1, 2002 – March 31, 2003

Judicial Actions:	
Indictments/Informations	13
Convictions	14
OIG Investigations Resulted in:	
Fines of	\$2,000
Restitution of	\$25,796,385
Other Monetary Recoveries of	\$398,500
Total	\$26,196,885
Cases Referred to the Department of Justice (U.S. Attorney)	
13	
Referrals to FDIC Management	
3	
OIG Cases Conducted Jointly with Other Agencies	
53	

The Office of Investigations (OI) is responsible for carrying out the investigative mission of the OIG. Staffed with agents in Washington, D.C., Atlanta, Dallas, and Chicago, OI conducts investigations of alleged criminal or otherwise prohibited activities impacting the FDIC and its programs. As is the case with most OIG offices, OI agents exercise full law enforcement powers as special deputy marshals, under a blanket deputation agreement with the Department of Justice. This will soon change, as a result of the November 2002 passage of the Homeland Security Act, which provides statutory law enforcement authority for certain OIGs, including the FDIC OIG. This statutory authority will take effect at the end of May 2003. In the interim, our office has been working with the other affected OIGs to develop a collective memorandum of understanding establishing an external review process to ensure that proper safeguards and management procedures are implemented in each affected OIG.

OI's main focus is on investigating criminal activity that may harm or threaten to harm the operations or the integrity of the FDIC and its programs. In pursuing these cases our goal, in part, is to bring a halt to the fraudulent conduct under investigation, protect the FDIC and other victims from further harm, and assist

the FDIC in recovery of its losses. Another consideration in dedicating resources to these cases is the need to pursue appropriate criminal penalties not only to punish the offender but to deter others from participating in similar crimes.

Joint Efforts

The OIG works closely with U.S. Attorney's Offices throughout the country in attempting to bring to justice individuals who have defrauded the FDIC. The prosecutive skills and outstanding direction provided by Assistant United States Attorneys with whom we work are critical to our success. The results we are reporting for the last 6 months reflect the efforts of U.S. Attorney's Offices in the District of Massachusetts, the Southern District of Iowa, the Southern District of West Virginia, the Northern District of Alabama, the Northern District of Texas, the Western District of Texas, the Central District of California, the Northern District of Georgia, the District of South Carolina, the District of Minnesota, the District of Colorado, the Eastern District of Pennsylvania, the Northern District of Mississippi, the Northern District of New Jersey, the Middle District of Florida, the Northern District of California, the District of Connecticut, the Northern District of Illinois, and the Eastern District of Michigan.

Support and cooperation among other law enforcement agencies is also a key ingredient for success in the investigative community. We frequently "partner" with the Federal Bureau of Investigation (FBI), the Internal Revenue Service (IRS), Secret Service, and other law enforcement agencies in conducting investigations of joint interest.

Results

Over the last 6 months OI opened 15 new cases and closed 26 cases, leaving 102 cases underway at the end of the period. Our work during the period led to indictments or criminal charges against 13 individuals and convictions of 14 defendants. Criminal charges remained pending against 14 individuals as of the end of the reporting period. Fines, restitution, and

recoveries stemming from our cases totaled almost \$26,196,885. The following are highlights of some of the results from our investigative activity over the last 6 months.

Fraud Arising at or Impacting Financial Institutions

Owners of Construction Company Convicted on Charges of Defrauding Community Bank of Blountsville, Alabama

On October 30, 2002, a jury in the U.S. District Court for the Northern District of Alabama returned guilty verdicts on all three counts of an indictment charging the two owners and their company, Morgan City Construction, with bank fraud and conspiracy to commit bank fraud.



Two individuals fraudulently submitted invoices for constructing a bank branch office and never completed the project.

At trial, the government presented evidence showing that between December 1997 and July 2000 the couple used Morgan City Construction, which they owned and operated, to submit invoices for construction work purportedly performed for Community Bank, an FDIC-regulated bank located in Blountsville, Alabama. Prosecutors alleged during the trial that some of the invoices were for work that was never performed and other invoices were for personal construction work performed for the bank's chief executive officer, his relatives, and the bank's vice president of construction and maintenance. Evidence was also presented to show that the records of the bank were falsified to reflect that the work was completed at the bank's facilities.

The charges against the defendants included a forfeiture claim seeking any property derived from the fraud scheme. Although the government alleged the couple

received a total of approximately \$1,685,000 as a result of the fraud scheme, the jury decided in separate deliberations that they only netted \$178,500 in illicit proceeds.

The investigation of suspected fraud involving Community Bank is being conducted by agents from the FDIC OIG, FBI, and IRS. Prosecution of the case is being handled by trial attorneys from the Department of Justice, Washington, D.C.

Former Chief Executive Officer of the Failed Bank of Falkner Pleads Guilty and Is Sentenced to Felony Charges of Making False Entries to Deceive FDIC Examiners and Money Laundering

On February 6, 2003, the former Chief Executive Officer of the Bank of Falkner Mississippi, was sentenced in U.S. District Court for the Northern District of Mississippi to serve 2 years in prison to be followed by 5 years' probation and ordered to pay the FDIC restitution of \$15,284,348.

The former Chief Executive Officer's sentencing follows his prior plea of guilty in October 2002 to two counts of making false entries in the books and records of the bank with the "intent to deceive the FDIC and its agents and examiners" and one count of money laundering. One of the counts was based on a scheme through which he issued \$4,824,660 in nominee loans to certain bank customers who were above their legal lending limits. Another count involved a scheme where he caused a bank employee to record advances of \$3,642,686 on existing loans and to misapply those advances to other customers' accounts to conceal overdrafts from the FDIC examiners. The money laundering charge to which he pled guilty was based on his helping a bank customer disguise the nature, location, source, and ownership of \$1,709,497 the customer had on deposit with the bank.

The prosecution of the former Chief Executive Officer was handled by the U.S. Attorney's Office for the Northern District of Mississippi and was based on an investigation conducted jointly by the FDIC OIG and the FBI that was initiated to examine the circumstances leading to the bank's failure in September 2000.

Former Officer of the Institution for Savings Is Sentenced for Misapplying Funds

On October 29, 2002, a former officer of the Institution for Savings (IFS) of Newburyport, Massachusetts, was sentenced in the U.S. District Court for the District of Massachusetts for misapplying the funds of the institution. She was sentenced to 15 months' imprisonment to be followed by 3 years of supervised release. She was also ordered to pay restitution in the amount of \$141,156.

As described in our last semiannual report, in July 2002, the U.S. District Court for the District of Massachusetts accepted a plea of guilty by the former officer of the IFS to 59 counts of misapplying a total of approximately \$162,000 of funds between February 1997 and March 2002 by negotiating her personal checks at IFS and then removing them from the bundle of items that IFS was sending to the Federal Reserve Bank for processing. Later, when the missing amounts were reported back to IFS, she would make entries in the books and records of IFS to conceal them.

The former officer used at least \$40,000 of the funds she took from IFS as a down payment when she purchased a home. At the sentencing she was also ordered to forfeit the proceeds from the sale of the home, which totaled approximately \$21,000.

The investigation of this case was conducted jointly by agents of the FDIC OIG and the FBI, and the prosecution was handled by the United States Attorney's Office for the District of Massachusetts.

Former Officials of Jasper State Bank Plead Guilty to Charges of Bank Fraud, Misapplication of Funds, and False Statements

In March 2003, two former officials of Jasper State Bank pled guilty in the U.S. District Court for the District of Minnesota to criminal charges relating to a bank fraud scheme. Specifically, the former director and executive vice president of the bank pled guilty to bank fraud, misapplication of funds, and making false entries in the bank's records, and the former head teller pled guilty to one count of bank fraud. Both

defendants had previously been indicted on similar charges in January 2003.

The former executive vice president of the bank and his brother-in-law were each 50 percent owners of the bank. As the executive vice president, he had extensive authority, served as a loan officer, and had unrestricted access to the bank's computer system. When entering his guilty plea, he admitted that between July 2000 and March 2002, he misapplied funds belonging to the bank by granting over \$800,000 in loans to nominee borrowers to disguise the true beneficiary of the loan proceeds. He also admitted that he made false entries in the books and records of the bank to conceal the loans, altered supporting loan documents, directed the manipulation of records pertaining to delinquent loans, and engaged in the falsification of vehicle inventory reports.

The former head teller admitted to aiding and abetting the executive vice president by making false entries in the records of the bank. Specifically, she admitted to making delinquent loan accounts current and to routinely falsifying inventory reports that were submitted to obtain loans from the bank by a company of which she was a part owner.

Jasper State Bank is a \$23 million bank located in rural Jasper, Minnesota, which has a population of less than 600. The bank incurred total losses of approximately \$2.7 million as a result of the loans originated by the defendants, well in excess of the \$2.4 million in the bank's capital and reserves, causing it to become insolvent. The bank was saved from failure by the injection of \$3 million in capital from two investors.

The investigation that led to the prosecutions was conducted jointly by agents from the FDIC OIG and the FBI. The case is being prosecuted by the U.S. Attorney's Office for the District of Minnesota.

Owner of Company Providing Automated Teller Machine Services Convicted and Sentenced in Fraud Scheme that Cost the FDIC \$9 Million

On January 14, 2003, the owner of several Texas

companies, including an armored car company and a company that owns and operates automated teller machines (ATMs) was sentenced in U.S. District Court, District of Colorado, Denver, Colorado, to a total of 70 months' imprisonment, to be followed by 5 years of supervised release. He was also ordered to pay a special assessment of \$4,300 to the court and restitution to the FDIC in the amount of \$9,284,457.

Following a 2-week trial in July 2002, the defendant was found guilty on all 46 counts of an indictment charging him with bank fraud, wire fraud, and money laundering for implementing a scheme to defraud the failed BestBank, Boulder, Colorado, and Pueblo Bank and Trust Company, Pueblo, Colorado, which acquired the insured deposits of the failed institution from the FDIC. The scheme ultimately cost the FDIC over \$9 million.

Prior to this sentencing, the defendant's motion for acquittal on three of the counts was granted based on the judge's finding that there was a lack of intent on his part sufficient for the jury to have found him guilty of money laundering.

The OIG's investigation, conducted jointly with the FBI, established that the defendant used his companies to divert bank funds designated to stock ATMs to accounts that he controlled. He ultimately used the diverted funds for business and related expenses rather than returning them to the bank.

Bookkeeper Indicted for Bank Fraud and Money Laundering

On February 11, 2003, a bookkeeper was indicted by a federal grand jury in the District of Minnesota on charges of bank fraud and money laundering. The indictment alleges that the defendant and others unnamed in the indictment executed a scheme to defraud the former Town & Country Bank of Almelund (Minnesota). Specifically, the defendant, who worked for a customer of the bank, is alleged to have received \$41,000 for signing 10 false loans that were obtained from the bank between March 1997 and June 1999, and had a total face value of \$371,000. When the bank

failed, the FDIC had to charge off \$267,000 in principal loss that was outstanding on the loans.

This case is being investigated jointly by the FDIC OIG and the IRS Criminal Investigations Division and is being prosecuted by the U.S. Attorney's Office for the District of Minnesota.

Vehicles Purchased with Proceeds of Suspected Check-Kiting Scheme Seized and Sold

As a part of an ongoing investigation that the OIG is conducting jointly with the FBI, three vehicles that were purchased with proceeds from a suspected check-kiting scheme at the former Universal Federal Savings Bank (UFSB), Chicago, Illinois, were seized during the reporting period and subsequently sold, with the proceeds going to the FDIC. The FDIC Division of Resolutions and Receiverships is also assisting in the investigation.



A 2003 Mercedes Benz SL500 and a 2002 Lexus LX470 were seized from a former customer of the bank, and a 2002 BMW 325xi that was purchased by the same customer was seized from the former Chief Operations Officer at UFSB. The FDIC closed UFSB in June 2002 as a result of the depletion of the institution's funds that were diverted as a part of the suspected check-kiting scheme. The vehicles were subsequently sold and the proceeds, which totaled \$164,500, were returned to the FDIC as partial reimbursement of the costs to the insurance fund attributable to the failure of UFSB.



Management and Sale of FDIC-Owned Assets Contractors Plead Guilty to Indictment Charging Them with Conspiracy and Submitting False Statements to the FDIC

On February 11, 2003, two principals of an FDIC contractor pled guilty in the U.S. District Court for the Middle District of Florida. One of the contractors pled guilty to one count of a four-count indictment that had

been returned by a federal grand jury in April 2001 charging her with conspiracy and making false statements to the FDIC. On February 14, 2003, her business associate, who was also charged in the same indictment, pled guilty to one count of the indictment.

As we previously reported, the indictment against the two individuals charged them with submitting three false invoices and bogus support documentation to the FDIC on behalf of Golden Ocala Golf Course Partners. These documents purported that Golden Ocala Golf Course Partners, a contractor hired by the FDIC, had paid a nonexistent company \$240,000 for environmental remediation work that was actually performed by other companies at a total cost of \$51,376. Based on this false documentation, the FDIC reimbursed the partnership \$150,000 for expenses.

The investigation and prosecution of these two individuals was initiated by the Department of Justice and the OIG based upon allegations contained in a civil complaint filed by a private citizen under the False Claims Act. In September 2000, one of the partners entered into an agreement whereby he agreed to pay the government \$300,000 to settle the civil complaint.

Former Employee of Contract Asset Manager Pleads Guilty to Theft of Government Funds

On December 5, 2002, a former employee of a company hired by the Resolution Trust Corporation (RTC) to manage assets was sentenced in the U.S. District Court for the Western District of Texas to 12 months of confinement and was ordered to pay restitution in the amount of \$257,593. The sentencing follows his prior plea of guilty in September 2002 to a one-count information charging him with theft of funds belonging to the FDIC.

As we reported in our last semiannual report, the FDIC OIG initiated an investigation based on a referral from the Division of Resolutions and Receiverships indicating that the asset manager may have been engaged in self-dealing in the sale of at least one asset. The investigation disclosed that the defendant used his position with the contractor to negotiate and sell FDIC assets to

entities with which he had undisclosed agreements to collect additional payments and fees. To hide his conflicting interests in the sale of assets, he arranged with his wife and one of his associates to form two companies for the sole purpose of purchasing properties from the portfolio of properties he was responsible for managing for the RTC/FDIC. Properties sold to these companies were re-sold shortly thereafter for a higher amount. In addition, the defendant also collected additional fees and payments during the sale of the assets.

Through his self-dealings, the defendant received approximately \$700,000 in kickbacks and caused the FDIC and asset management company losses of approximately \$1.2 million. In her capacity as the designated owner of one of the companies, the defendant's wife has settled a civil suit filed against her by the asset management company for \$541,000, which represents the financial gain realized by that company as a result of self-dealings. The asset management company, in turn, remitted these settlement funds to the FDIC. The asset management company has also received an "Arbitration Award" against the asset specialist for

- ☆ actual damages of \$631,256,
- ☆ punitive damages of \$150,000,
- ☆ arbitration costs/expenses of \$12,900,
- ☆ prejudgment interest on actual damages of \$111,121, and
- ☆ post-judgment interest of 10 percent per annum on the entire award.

This investigation was conducted jointly with the FBI, and the criminal prosecution is being pursued by the U.S. Attorney's Office for the Western District of Texas.

Restitution and Other Debt Owed the FDIC Debtor Indicted for Providing False Financial Information

On January 30, 2003, a debtor was indicted by a federal grand jury in the Eastern District of Pennsylvania on four counts of making false statements to the former RTC.

According to the indictment, from July 1990 through March 1993, the debtor was negotiating with the former RTC to resolve his outstanding obligations as a result of loans he guaranteed with Gold Coast Federal Savings Bank, Plantation, Florida (Gold Coast), and Atlantic Financial Savings, FA, Bala Cynwyd, Pennsylvania (Atlantic Financial). The defendant was a personal guarantor on 11 loans from Gold Coast with a book value of approximately \$6.67 million and on 4 loans from Atlantic Financial with a book value of approximately \$3.93 million. The loans became the responsibility of the former RTC as a result of the failure of those institutions.

The indictment alleges that in February 1993, the debtor knowingly made false statements to the RTC in that he falsely reported on a financial statement and in a financial affidavit submitted to the former RTC that he did not own and control securities of value when, in fact, he owned and controlled approximately \$157,311 in Jefferson Bank stock. The indictment also charged him with falsely reporting in the financial affidavit that he received nothing from the sale of a Wilmington, Delaware, apartment complex, when the debtor had actually received at least \$125,000 from the sale. According to the indictment, he concealed his ownership of the Jefferson Bank stock and the proceeds from the sale of the apartment complex by transferring them to a trust account purportedly established for the benefit of his son.

FDIC Debtor and His Girlfriend Indicted for Concealing Assets from the FDIC and Making False Statements to the Government

On October 31, 2002, a federal grand jury in Hartford, Connecticut, indicted two defendants in connection with an alleged scheme to conceal assets to avoid payment of \$2.7 million in restitution. One of the defendants owes the restitution to the FDIC as a result of his prior conviction in 1996 on bank fraud charges. He is charged in the subject indictment with one count of concealing assets and four counts of making false statements. His girlfriend is charged with aiding and assisting him in the concealment of assets.



An FDIC debtor attempted to conceal this property from the FDIC by transferring ownership to his girlfriend.

With respect to the concealment of assets, the indictment alleges that between June 1999 and August 2002, the defendant conducted four real estate transactions so that all the financial and land records showed his girlfriend as the sole owner. In fact, he arranged for the purchase and finance of the properties, used his funds to improve the properties, and shared in the profits upon sale of two of the properties. His girlfriend is accused of using her bank accounts to assist him to conceal his involvement in these transactions.

One of the false statement charges alleges that he submitted false information to the Financial Litigation Unit of the U.S. Attorney's Office relating to a \$100,000 government bond he received pursuant to a divorce settlement. The other three false statement counts pertain to information he submitted to the U.S. Probation Office indicating that his solely owned businesses had not conducted any transactions for years. The indictment alleges that, in reality, those companies were doing substantial business and that substantial sums of money had passed through the checking accounts of the corporations.

FDIC Debtor Arrested on Charges of Wire Fraud

An FDIC debtor, who is believed to maintain a residence in Alamos, Mexico, was arrested in La Quinta, California, on October 22, 2002, by agents of the FDIC OIG and FBI on wire fraud charges related to his promised development of Country Club of the Desert in La Quinta.

According to an affidavit filed in support of an arrest warrant, the debtor began doing business as Equity Funding Corporation (EFC) in September 1996. He controlled the money and made business decisions related to EFC as well as numerous limited liability companies and limited partnerships related to EFC. After raising capital and assembling land under several limited partnerships, he established Country Club

Properties, LP (CCP) for the purpose of developing a 54-hole golf course and residential development called Country Club of the Desert. Investors who eventually gave the individual nearly \$20 million were told that all money invested would go toward the development of Country Club of the Desert. While he did develop a golf course, he diverted a substantial portion of investor money from CCP, through EFC, to his own accounts for his personal use and benefit.

From approximately mid-1997 until November 2001, when the investors had him replaced, the debtor allegedly diverted approximately \$3.4 million from CCP for his personal use and spent it on two planes, a yacht, and various residential and investment properties in California and Mexico. The defendant was charged with wire fraud, a felony offense which carries a maximum possible sentence of 5 years in prison and a \$250,000 fine.

This case is the result of a joint investigation by the FBI and the FDIC OIG.

Strawbuyer in Debt Fraud Scheme Pleads Guilty to Conspiracy to Defraud the FDIC

On February 6, 2003, a financial facilitator pled guilty in U.S. District Court for the Eastern District of Michigan to a one-count criminal information charging him with conspiring to defraud the FDIC. The defendant is a former employee of the RTC who opened his own company, EJM & Associates Inc., after leaving the government.

According to the information to which he pled guilty, the defendant conspired with two Michigan businessmen who defaulted on two loans in March 1993 totaling \$4.2 million that they had obtained from First Federal Savings Bank and Trust of Pontiac, Michigan. When First Federal Savings Bank failed, the loans were taken over by the RTC and later the FDIC, and the FDIC decided to sell them in a public auction. As alleged in the information, the businessmen wired a total of approximately \$2.5 million to the defendant in April 1998 to buy the two delinquent loans, which by then had a \$5.6 million payoff value. The defendant bought the loans for \$2 million, kept the remaining

approximate \$500,000, and transferred the loans to an intermediary, who subsequently transferred them back to the original debtors. As a part of the transaction, the defendant certified that he was not representing the two original debtors.

Purportedly, the businessmen hoped that by cleaning up their financial problems related to loans, they would be more likely to receive approval from the Michigan Gaming Control Board to become 40-percent stakeholders in a Michigan casino. According to a news article regarding the alleged conspiracy, the two businessmen and their wives were ultimately forced to sell their stake in the casino in August 2000 because the gaming board found problems in their financial background and would not license the casino if they were involved. The board never disclosed the problem. The couples sold their interest for \$275 million.

As a part of his plea agreement with the government, the defendant is cooperating in the ongoing investigation. The investigation was conducted jointly by the agents of the FDIC OIG, the IRS, and the FBI. Prosecution of the case is being pursued by the U.S. Attorney's Office for the Eastern District of Michigan.

Misrepresentations Regarding FDIC Insurance or Affiliation

Securities Dealer Pleads Guilty to Selling Unregistered Securities, Fraud, and Theft

On October 31, 2002, a securities dealer pled guilty in the Superior Court of California, Riverside County, to an amended complaint charging him with selling unregistered securities, fraud, and theft.



Sample advertisement misrepresenting FDIC insurance coverage for Jeffco CDs.

As reported in our last semiannual report, the subject was arrested on similar charges by agents of the FDIC OIG and the Riverside County (California) District Attorney's Office on October 7, 2002. The subject, doing business as Jeffco Financial Services, was licensed to sell securities through San

Clemente Services, Inc., another company involved in the sale of brokered certificates of deposit. Relying on information they were provided regarding FDIC insurance coverage, investment yields, fees, and commissions, investors purchased approximately 1,241 certificates of deposit totaling \$67,390,735 from Jeffco Financial Services. The felony complaint to which the subject pled guilty lists the names of 59 individuals or entities to whom he offered or sold unregistered securities which are described in the complaint as “investment contracts in the form of interests in custodialized certificates of deposit.” He also pled guilty to making misrepresentations regarding “annual average yield,” theft of property exceeding \$2.5 million in value, and participating in a pattern of felony conduct involving the taking of more than \$500,000.

The OIG investigation was initiated based on a referral by the Division of Supervision and Consumer Protection of information obtained during the examination of a bank indicating irregularities in deposits the bank had placed with San Clemente Services. The prosecution of the case is being handled by the Riverside County District Attorney’s Office.

Employee Activities

Former FDIC Employee Pleads Guilty and Is Sentenced for Theft

On February 28, 2003, a former Print Shop Supervisor at the FDIC’s Virginia Square facility was sentenced in the State Court for the Commonwealth of Virginia to 12 months’ imprisonment, all suspended, and 12 months’ supervisory probation.

In December 2002, the defendant entered a guilty plea to violating Virginia’s felony statute prohibiting theft of cable services. In February 2002, the OIG received information from the Division of Administration regarding the possible sale of cable television converter boxes by the former FDIC employee. The OIG and Arlington County Police worked with a confidential informant to contact the former employee for the purpose of purchasing cable boxes. Based on the joint investigation, the former employee was arrested and charged with possession of stolen property.

Sentencing

Witness Is Sentenced for Theft of Government Funds

On October 17, 2002, a witness who had been interviewed as a part of an OIG investigation into alleged concealment of assets was sentenced in the U.S. District Court for the District of Massachusetts to theft of government funds. The witness had been previously indicted and pled guilty for receiving approximately \$45,000 in Social Security disability benefits to which he was not entitled.

As previously reported, the witness was contacted as a part of an OIG investigation because of his affiliation with a suspect who was allegedly concealing assets to avoid paying \$5 million in restitution he owed the FDIC resulting from his conviction on bank fraud charges in 1991. Because of apparent false information provided by the witness in an affidavit, additional investigation was conducted disclosing that he had been continuing to receive Social Security disability benefits to which he was not entitled.

Former Bank Board Members of Hartford-Carlisle Savings Bank Sentenced for Bank Fraud

On March 27, 2003, two brothers, both of whom were former board members of the now defunct Hartford-Carlisle Savings Bank (HCSB), Carlisle, Iowa, were sentenced in U.S. District Court for the Southern District of Iowa. One of the brothers was sentenced to 5 days’ incarceration, 5 years’ probation, and ordered to pay restitution to the FDIC in the amount of \$201,441. The other brother was sentenced to 4 days’ incarceration, 5 years’ probation, and ordered to pay restitution to the FDIC in the amount of \$226,614.

In September 2002, the two brothers entered guilty pleas to bank fraud for making or causing to be made false statements to the Federal Reserve Bank in connection with an application to acquire the stock of HCSB. HCSB was an FDIC-regulated institution that was closed on January 14, 2000, by the Iowa Division of Banking. Subsequently, the FDIC OIG and the FBI conducted a joint investigation regarding suspected illegal activities that led to HCSB’s closure. The U.S.

Attorney's Office for the Southern District of Iowa has handled prosecution of this case.

In addition to the prosecutions of the two brothers, the investigation has also resulted in a guilty plea by a third brother, who was the former president of HCSB, to four counts of making false entries in the records of HCSB and four counts of making false statements. He is currently awaiting sentencing on those charges.

Woman Sentenced to Over 14 Years in Prison for Theft of Keystone-Related Assets

On February 18, 2003, a woman was sentenced in the U.S. District Court for the Southern District of West Virginia to 14 years and 7 months in prison for violations of federal law arising from a scheme to obtain property and other assets owned by the former senior executive vice president and chief operating officer (COO) of the First National Bank of Keystone (West Virginia). The former senior executive vice president and COO is currently in prison serving sentences in excess of 27 years as a result of her convictions for obstruction of an examination of the bank, bank fraud, money laundering, embezzlement, mail fraud, and conspiracy. She has also been ordered to pay in excess of \$818 million in restitution. As a part of the prosecution of the cases against the former senior executive vice president and COO, an injunction was obtained by the government to protect the value of assets that might be used to satisfy any judgement obtained by the FDIC against her.

The woman sentenced more recently, previously a convicted felon, was once a prison inmate with the former senior executive vice president and COO. Upon her release from prison, she participated in a scheme to fraudulently obtain some of the assets that had been frozen by the injunction and resell them to individuals in four states, collecting in excess of \$170,000. As a part of the scheme, she falsified a document that contained a facsimile of the signature of a United States District Court Judge, which she used to obtain possession of some of the property. Included among the assets she illegally obtained were firearms, classic automobiles, Harley-Davidson motorcycles, a pontoon boat, a ski

boat, sports utility vehicles, a tractor, and various other types of vehicles and farm equipment. She was also convicted and sentenced for being in possession of 17 handguns formerly belonging to the former senior executive vice president and COO's family.

Other

Man Who Posed as "FDIC Inspector" Is Sentenced for Fraudulent Use of Bank Routing and Account Numbers

On January 29, 2003, a man who had posed as an "inspector" with the FDIC was sentenced in the U.S. District Court for the Northern District of Texas to 5 years' probation and 90 consecutive days of home confinement with electronic monitoring. The sentencing was based on his prior plea agreement with the United States Attorney's Office whereby he pled guilty to one count of fraudulent use of an access device.

The OIG investigation that resulted in the prosecution of the defendant was initiated based upon a referral from a case manager in the former Division of Supervision who reported that he had received two phone calls from businesses located at Preston Forest Village shopping center. Both callers said that a man representing himself as an "inspector" with the FDIC had asked to look at their credit card machines and merchant account statements. The investigation disclosed the individual was a man who was employed at the time by a company that sells credit card processing services and payment systems to small businesses. Upon learning of his misrepresenting himself as an FDIC inspector, the company terminated his employment.

Further OIG investigation of his related activities disclosed that the defendant had been employed as a collection representative by The Associates National Bank, Irving, Texas, and, as such, had access to the bank routing and account numbers of the bank's credit card clients. In February 2001, he opened an account at Chase Manhattan Bank, Irving, Texas. He then falsely made 10 checks totaling approximately \$7,062 using the bank account numbers of clients of The Associates National Bank and deposited the checks into his account at Chase Manhattan Bank.



OIG Submits Proposal to House Financial Services Committee to Enhance Enforcement Authority for Misrepresentations Regarding FDIC Insurance

FDIC OIG investigations have recently identified multiple schemes to defraud depositors by offering them misleading rates of return on deposits. These abuses are effected through the misuse of the FDIC's name, logo, abbreviation, or other indicators suggesting that products are fully insured deposits. Such misrepresentations induce the targets of schemes to invest on the strength of FDIC insurance while misleading them as to the true nature of the investment products being offered. These depositors, who are often elderly and dependent on insured savings, have lost millions of dollars in the schemes. Depositors may be particularly attracted to these misrepresented investments in our current economy when interest paid on insured deposits is historically low and uninsured investments can put an investor's principal at substantial risk. Further, we are concerned that abuses of this nature may erode public confidence in federal deposit insurance. Our semiannual reports to the Congress have provided information on cases we have successfully investigated involving these types of misrepresentations, including one case of \$9.1 million worth of certificates of deposit misrepresented to about 90 investors, most of whom were elderly.

The FDIC currently has no direct enforcement authority over these misrepresentations. The FDIC may, of course, generally address misconduct occurring in state chartered banks where the FDIC is the primary federal regulator, but the abuses described above generally were perpetrated outside of that system. We have proposed legislation to strengthen the FDIC's enforcement authority to curtail these abuses by granting the FDIC the authority to impose civil monetary penalties of up to \$1 million per day on any person who falsely represents the nature of the product offered or the FDIC insurance coverage available. The proposal can be accomplished by amending the Federal Deposit Insurance Act to insert a new subparagraph outlining the enforcement authority for such abuses.

The OIG submitted this proposed legislation to Representative Michael G. Oxley, Chairman, Committee on Financial Services, U.S. House of Representatives, on March 4, 2003. As of April 10, 2003, the proposal had been passed by the House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Affairs, and was scheduled for mark-up by the House Financial Services Committee at a time to be determined.

OIG Organization



The OIG has now nearly completed its downsizing and reorganization efforts and is streamlined, stabilized, and well positioned to help the Corporation address the major challenges it faces. As we reported in our last semiannual report, the OIG dramatically downsized and reorganized. During this period it completed its reorganization, combining the Office of Management and Policy and Office of Policy Analysis and Congressional Relations to create an Office of Management and Congressional Relations. This office provides business support for the OIG, including financial resources, human resources, and information technology support, and coordinates OIG policy development, policy analyses, and congressional relations. The OIG also established the position of Senior Communications Manager in the Immediate Office of the Inspector General.

As discussed earlier in this report, having identified the most significant Management and Performance Challenges currently facing the FDIC and having communicated those to the Corporation, the OIG's main work is focused on addressing them. We continue to pursue audits, evaluations, investigations, and other reviews that address these challenges.

Strategic Planning and Reporting

During the reporting period, and as also discussed in the Management and Performance Challenges section of this semiannual report, we acknowledged the Corporation's substantial effort and accomplishment in preparing its first consolidated annual report, which integrates the Chief Financial Officers Act Report, the Government Performance and Results Act Performance Report, and the Annual Report. We believe this initiative represents a significant step in improved accountability and reporting.

The OIG has also continued to work to improve the quality of our goals, objectives, and performance measures by making strategic changes that align our planning reporting requirements more closely with our budget process and reporting requirements of the Inspector General Act. During this period, we issued

our *2003 Performance Plan*, covering the period October 1, 2002 through September 30, 2003. This plan represents the first full year of conversion from a calendar year to the federal fiscal year ending September 30. The change to a typical government fiscal year will enable our performance planning to be better integrated with our appropriation budgeting and our semiannual reporting to the Congress as prescribed in the Inspector General Act.

Our performance plan includes an updated strategic framework with improved linkages to the FDIC Strategic Plan, OIG Human Capital Strategic Plan, Office of Audits' Assignment Plan, and the OIG-identified Management and Performance Challenges facing the FDIC. The updated performance plan reflects the OIG's emphasis on adding value to the Corporation through our core mission activities of audits, evaluations, and investigations; improving communications with our stakeholders; aligning human resources to support the OIG mission; and managing our resources effectively.



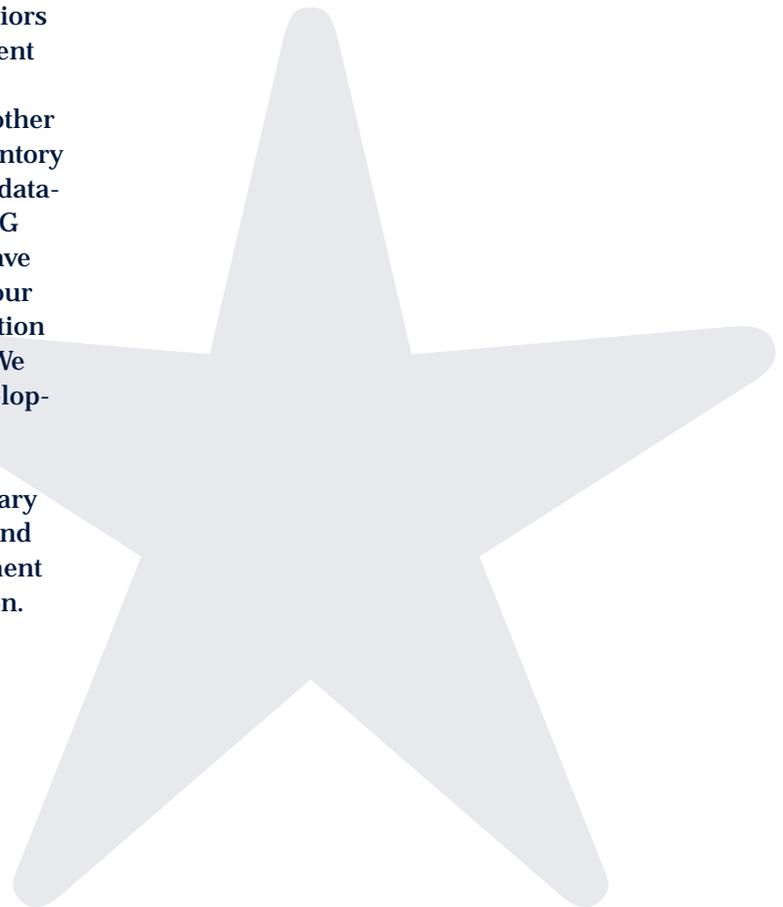
Lien Nguyen is working in the OIG's Information Assurance audit group as part of the Scholarship for Service program.

Continued Focus on Human Capital

During this reporting period the OIG turned to the operational and human capital-related challenges that inevitably resulted from the recent dramatic reduction in our workforce. As reported in our last semiannual report, the OIG issued a Human Capital Strategic Plan to align and integrate our human resource policies and practices with the OIG mission, which is also a new strategic goal in our 2003 Performance Plan. The

Human Capital Strategic Plan features four objectives designed to increase the value of our people and the performance capacity of the OIG and sustain a high-performance organization. The objectives relate to (1) workforce analysis, (2) competency investments, (3) leadership development, and (4) sustaining a high-performance organization.

Of particular note during this period, the OIG initiated two key efforts under our Human Capital Strategic Plan, identification of key staff competencies needed to perform our work and development of a business knowledge inventory system. These two efforts form the underpinnings for other parts of our plan that relate to making human capital investments in training, professional development, and recruitment. The identified core competencies and associated behaviors will be used to revise performance criteria consistent with those competencies and identify areas where development or training might be necessary. The other ongoing key project, The Business Knowledge Inventory System, will ultimately enable the OIG to create a database of the collective business knowledge of all OIG employees and determine where our office may have gaps between the knowledge we need to perform our current and future audit, evaluation, and investigation work and the knowledge we collectively possess. We will address the identified gaps with training, developmental assignments, recruitment, or contracting, depending on the circumstances. Our intent is to ensure that the OIG will have the expertise necessary to carry out our strategic and performance plans and successfully conduct work related to the Management and Performance Challenges facing the Corporation.



Internal OIG Activities

- Issued the OIG's FY 2003 Performance Plan, which reflects an updated strategic framework with improved linkages to the FDIC Strategic Plan, the OIG Human Capital Strategic Plan, the OIG Office of Audits' Assignment Plan, and the OIG-identified Management and Performance challenges facing the FDIC.
- Issued the OIG's 2002 Performance Report.
- Conducted our fourth external customer survey regarding satisfaction with OIG products, processes, and services and initiated the process for conducting the fifth external customer survey.
- Participated in inter-agency Government Performance and Results Act (Results Act) interest groups sponsored by the President's Council on Integrity and Efficiency, the National Academy of Public Administration, and the U.S. Office of Personnel Management to share ideas and best practices on Results Act implementation.
- Submitted Fiscal Year 2004 Appropriation Request for \$30.1 million to fund 168 positions and other resources. The Fiscal Year 2004 budget is \$1.3 million less than the Fiscal Year 2003 appropriation.
- Completed two internal quality reviews on (1) Continuing Professional Education Credits and (2) the Office of Audits' Internal Management Control and followed up on an earlier quality control review of Management Control Assessments.
- Participated in a President's Council on Integrity and Efficiency working group looking into the use of social security numbers in the federal government and concerns related to identity theft and issued a related report, as discussed on page 22.
- Administered the OIG's Business Knowledge Inventory System data collection instrument to all staff.
- Issued Office of Audits' Assignment Plan for Fiscal Year 2003 outlining the audits and evaluations planned for fiscal year 2003. Our planned work addresses the Corporation's three principal operational areas as presented in the 2002 Corporate Annual Performance Plan: Insurance, Supervision, and Receivership Management.
- Shared our OIG Training and Professional Development System with OIGs at the Department of Commerce and the Department of Interior for their use. The OIG Training and Professional Development System is a Web-based system that provides OIG management and staff with an online processing capability and timely information that is used to meet professional standards and requirements for continuing professional education.
- Co-sponsored Emerging Issues Symposium with Treasury and Federal Reserve Board OIGs.
- Participated in the Accelerated Financial Statement Reporting Audit Working Group (includes FDIC, U.S. Postal Service, Environmental Protection Agency, and Department of Defense OIGs).
- Continued active participation in the Federal Audit Executive Council.
- Coordinated with other federal OIGs on ongoing work of mutual interest and best practices.
- Inspector General gave numerous speeches and presentations to such organizations as the Institute for Internal Auditors, Association of Government Accountants, American Society for Public Administration, and to delegations of foreign visitors interested in the role and mission of the Inspector General Community.
- Participated in Scholarship for Service program to provide an opportunity for college students to work in the federal information security field.

Coordination with and Assistance to FDIC Management

- Provided risk-based assessment of management and performance challenges to the Chief Financial Officer.
- Provided advisory comments to management on the FDIC's 2003 Annual Performance Plan and 2002 Annual Report.
- Provided the Corporation with an updated risk analysis document on the Quality of Bank Financial Reporting and Auditing and Corporate Governance.
- Completed an annual review of the Corporation's Internal Control and Risk Management Program, concluding that the program was conducted in accordance with FDIC policy and was consistent with provisions of the Federal Managers' Financial Integrity Act.
- Provided comments to the Chief Operating Officer on the Corporation's draft Emergency Response Plan.
- Reviewed 35 proposed FDIC policies and provided substantive policy suggestions on such matters as security policies and procedures for FDIC contractors and subcontractors, access control, reporting computer security incidents, and the FDIC's software configuration management policy.
- Participated in quarterly meetings with DSC Field Office Supervisors and Division Heads (DSC, DOF, OICM, DRR, Legal) to discuss current and planned work and efforts toward resolving open issues.
- Gave presentations at DSC Commissioned Examiner Seminars to foster a better understanding of OIG work.
- Participated in the Risk Management Examination Process Redesign III, topic: delegations from DSC regional offices to field offices regarding lower risk banks.

**Table 1: Significant OIG Achievements
(October 2002 – March 2003)**

Audit and Evaluation Reports Issued	27
Questioned Costs and Funds Put to Better Use	\$1.26 million
Investigations Opened	15
Investigations Closed	26
OIG Subpoenas Issued	13
Convictions	14
Fines, Restitution, and Monetary Recoveries	\$26.2 million
Hotline Allegations Referred	10
Proposed Regulations and Legislation Reviewed	2
Proposed FDIC Policies Reviewed	35
Responses to Requests and Appeals under the Freedom of Information and/or Privacy Acts	2

Table 2: Nonmonetary Recommendations

October 2000 – March 2001	90
April 2001 – September 2001	34
October 2001 – March 2002	68
April 2002 – September 2002	73
October 2002 – March 2003	90

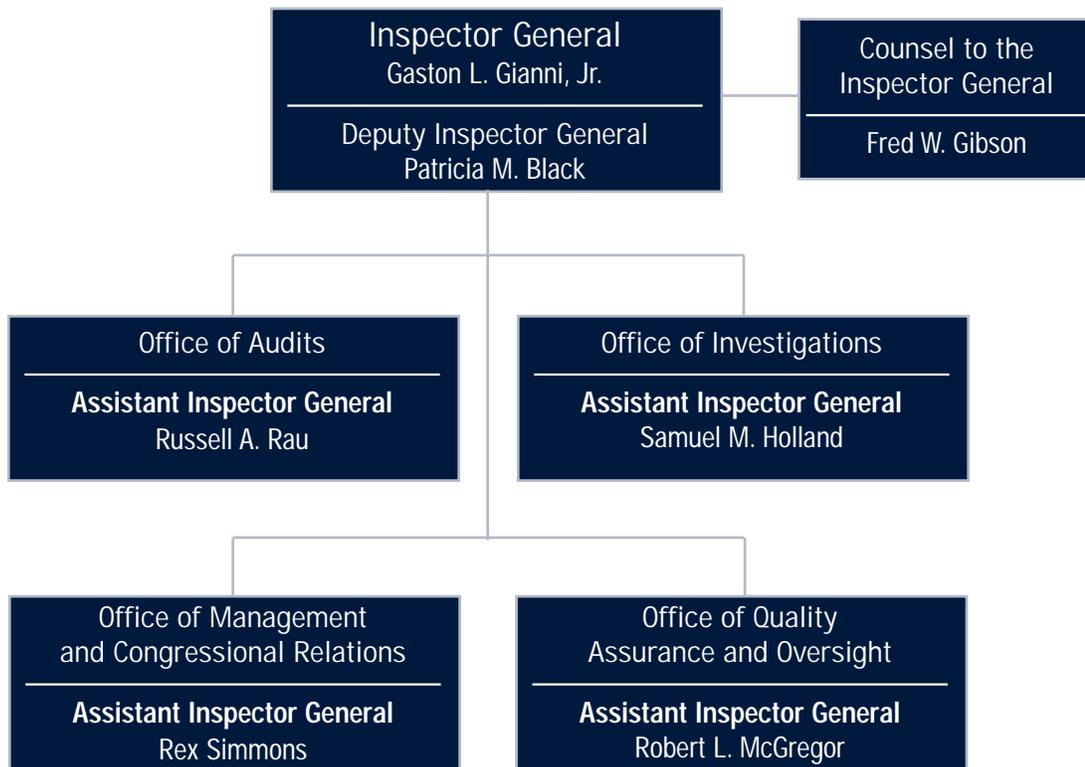
OIG Counsel Activities (October 2002 – March 2003)

The Mission of the Office of Counsel

The Office of Counsel provides legal advice and assistance on the range of issues that have faced, are facing, or will face the OIG. The Office litigates (or assists in litigating) personnel and other cases; provides advice and counsel on matters arising during the course of audits, investigations, and evaluations, including reviewing reports for legal sufficiency; reviews, analyzes, and comments on proposed or existing regulations or legislation, including banking legislation and implementing regulations; communicates and negotiates with other entities on behalf of the OIG; responds to Freedom of Information Act and Privacy Act requests and appeals; prepares and enforces subpoenas for issuance by the Inspector General; and coordinates with the Legal Division, the Department of Justice, and other agency and governmental authorities. Examples include:

Litigation	Counsel's Office represented the OIG in a hearing before a Merit Systems Protection Board administrative judge during the reporting period, involving a claim brought by a former employee. The Office of Counsel assisted the FDIC in litigating a matter and was involved in 23 other litigation matters that are awaiting further action by the parties or rulings by the court or other adjudicatory bodies.
Advice and Counseling	Counsel's Office provided advice and counseling, including written opinions, on issues including closed bank matters and bank supervision; the Prompt Corrective Action provisions of the Federal Deposit Insurance Act; the role of independent public accountants; review of the Sarbanes-Oxley Act; investigative matters; contract interpretations; and various ethics-related matters. In addition, Counsel's Office provided comments relative to the legal accuracy and sufficiency of 11 audit and evaluation reports.
Legislation/Regulation Review	During this reporting period, Counsel's Office commented on one proposed piece of legislation. Counsel also reviewed one proposed formal FDIC regulation and 11 FDIC policies.
Subpoenas	Counsel's Office prepared 13 subpoenas for issuance by the Inspector General during this reporting period.
Freedom of Information Act/Privacy Act	Counsel's Office responded to 2 requests under the Freedom of Information Act.

Organization Chart



Inspector General	Gaston L. Gianni, Jr.	202-416-2026
Deputy Inspector General	Patricia M. Black	202-416-2474
Counsel to the Inspector General	Fred W. Gibson	202-416-2917
Assistant Inspector General for Audits	Russell A. Rau	202-416-2543
Deputy Asst. Inspector General for Audits	Stephen Beard	202-416-4217
Deputy Asst. Inspector General for Audits	Sharon Smith	202-416-2430
Assistant Inspector General for Investigations	Samuel Holland	202-416-2912
Assistant Inspector General for Management and Congressional Relations	Rex Simmons	202-416-2483
Assistant Inspector General for Quality Assurance and Oversight	Robert L. McGregor	202-416-2501

Figure 1: Products Issued and Investigations Closed

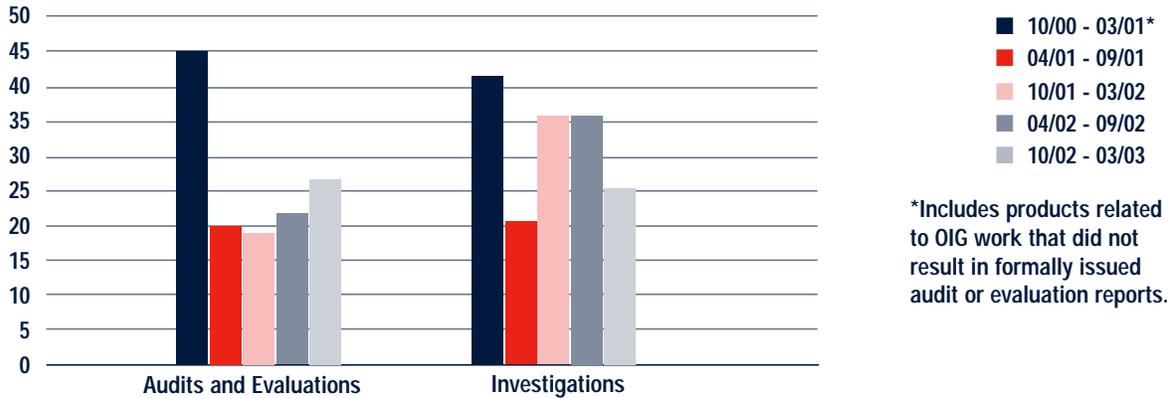


Figure 2: Questioned Costs/Funds Put to Better Use (in millions)

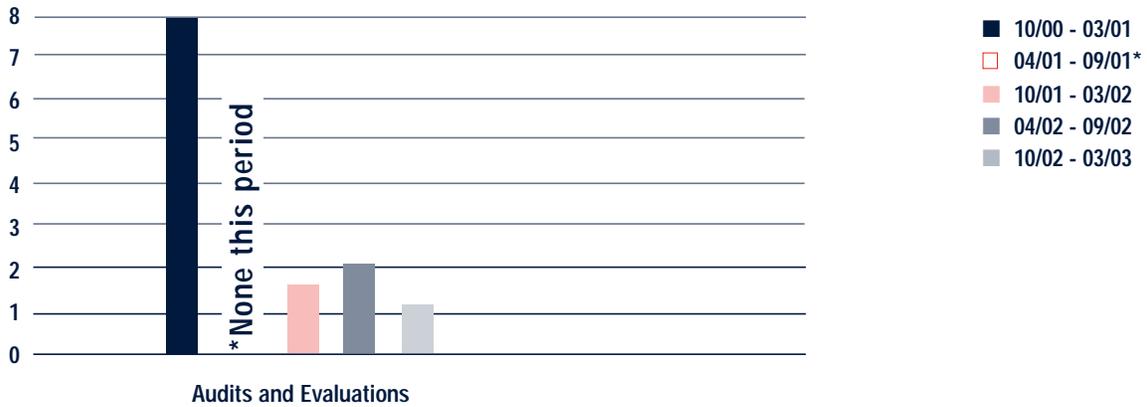
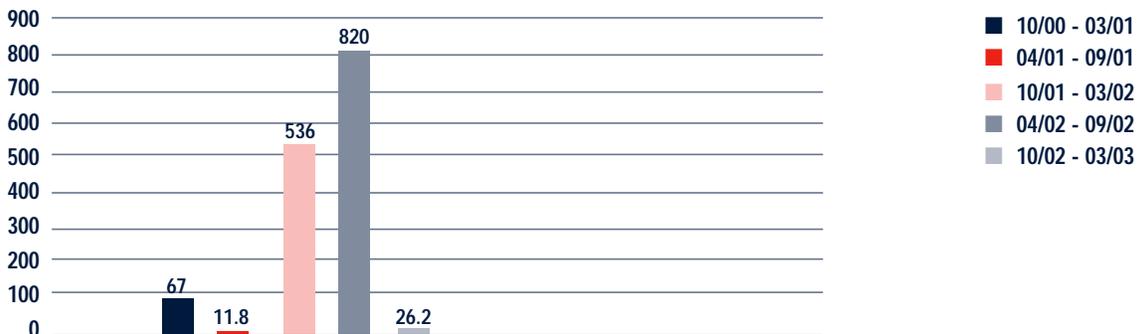


Figure 3: Fines, Restitution, and Monetary Recoveries Resulting from OIG Investigations (in millions)





FDIC Inspector General Involvement in IG Community

As Vice Chair of the President's Council on Integrity and Efficiency (PCIE), the Inspector General chaired monthly Council meetings and welcomed guest speakers from the Office of Management and Budget, U.S. General Accounting Office (GAO), the Administration, and individual OIGs to discuss issues related to the Inspector General community. He spearheaded efforts to commemorate the upcoming 25th anniversary of the Inspector General Act. He also continued a variety of initiatives, including preparing the PCIE and the Executive Council on Integrity and Efficiency (ECIE) *A Progress Report to the President*, assisting with the annual PCIE/ECIE conference and awards program, and representing the PCIE as a speaker in various conferences, meetings, and foreign visitor programs.

As the FDIC Inspector General, he met monthly with other federal regulatory Inspectors General to address matters of mutual concern. He also met and discussed with GAO representatives the various governmentwide issues and projects affecting the FDIC as well as the OIG.



Reporting Terms and Requirements

Index of Reporting Requirements - Inspector General Act of 1978, as amended

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Reader's Guide to Inspector General Act Reporting Terms

What Happens When Auditors Identify Monetary Benefits?

Our experience has found that the reporting terminology outlined in the Inspector General Act of 1978, as amended, often confuses people. To lessen such confusion and place these terms in proper context, we present the following discussion:

The Inspector General Act defines the terminology and establishes the reporting requirements for the identification and disposition of questioned costs in audit reports. To understand how this process works, it is helpful to know the key terms and how they relate to each other.

The first step in the process is when the audit report identifying **questioned costs**[▼] is issued to FDIC management. Auditors question costs because of an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds. In addition, a questioned cost may be a finding in which, at the time of the audit, a cost is not supported by adequate documentation; or, a finding that the expenditure of funds for the intended purpose is unnecessary or unreasonable.

The next step in the process is for FDIC management to make a decision about the questioned costs. The Inspector General Act describes a "management decision" as the final decision issued by management after evaluation of the finding(s) and recommendation(s) included in an audit report, including actions deemed to be necessary. In the case of questioned costs, this management decision must specifically address the questioned costs by either disallowing or not disallowing these costs. A "disallowed cost," according to the Inspector General Act, is a questioned cost that management, in a management decision, has sustained or agreed should not be charged to the government.

Once management has disallowed a cost and, in effect, sustained the auditor's questioned costs, the last step in the process takes place which culminates in the "final action." As defined in the Inspector General Act, final action is the completion of all actions that management has determined, via the management decision process, are necessary to resolve the findings and recommendations included in an audit report. In the case of disallowed costs, management will typically evaluate factors beyond the conditions in the audit report, such as qualitative judgements of value received or the cost to litigate, and decide whether it is in the Corporation's best interest to pursue recovery of the disallowed costs. The Corporation is responsible for reporting the disposition of the disallowed costs, the amounts recovered, and amounts not recovered.

Except for a few key differences, the process for reports with recommendations that **funds be put to better use** is generally the same as the process for reports with questioned costs. The audit report recommends an action that will result in funds to be used more efficiently rather than identifying amounts that may need to be eventually recovered. Consequently, the management decisions and final actions address the implementation of the recommended actions and not the disallowance or recovery of costs.

[▼]It is important to note that the OIG does not always expect 100 percent recovery of all costs questioned.

Appendix I: Statistical Information Required by the Inspector General Act of 1978, as amended

Table I.1: Significant Recommendations from Previous Semiannual Reports on Which Corrective Actions Have Not Been Completed



This table shows the corrective actions management has agreed to implement but has not completed, along with associated monetary amounts. In some cases, these corrective actions are different from the initial recommendations made in the audit reports. However, the OIG has agreed that the planned actions meet the intent of the initial recommendations. The information in this table is based on (1) information supplied by the FDIC's Office of Internal Control Management (OICM) and (2) the OIG's determination of closed recommendations for reports issued after March 31, 2002. These 35 recommendations from 8 reports involve monetary amounts of over \$5.7 million. OICM has categorized the status of these recommendations as follows:

Management Action in Process: (16 recommendations from 6 reports)

Management is in the process of implementing the corrective action plan, which may include modifications to policies, procedures, systems or controls; issues involving monetary collection; and settlement negotiations in process.

Litigation: (19 recommendations from 2 reports, \$5.7 million)

Each case has been filed and is considered "in litigation." The Legal Division will be the final determinant for all items so categorized.

**Report Number,
Title,
and Date**

**Significant
Recommendation
Number**

**Brief Summary of Planned
Corrective Actions and
Associated Monetary Amounts**

Management Action In Process

EVAL-01-002 FDIC's Background Investigation Process for Prospective and Current Employees August 17, 2001	3	Re-designate position sensitivity levels for examiner positions to reflect their public trust responsibilities.
	4	Alert the Security Management Section of all personnel assignments to positions where users have access to sensitive computer systems or data.
01-024 FDIC's Identification of and Accounting for Unclaimed Deposits Transferred to State Unclaimed Property Agencies December 5, 2001	1	Update both the Unclaimed Deposits Reporting System and the Corporate Accounts Receivable Management System with all unclaimed deposits that the FDIC transferred to state unclaimed property agencies and ensure that the two systems agree.
02-024 Marketing and Resolution of Superior Federal, FSB (New Superior) July 24, 2002	3	Review billings submitted by Fintek since February 12, 2002, and ensure that all payments comply with the terms of the contractual agreement.
02-023 Internal and Security Controls Related to the General Examination System (GENESYS) July 31, 2002	1	Implement security measures that provide assurance that confidential bank examination data processed by GENESYS will be adequately protected from unauthorized disclosure or alteration.
	3*	Discontinue the practice of using shared or office- wide passwords when accessing GENESYS to conduct safety and soundness examinations.
02-027 Computer Security Incident Response Team Activities August 28, 2002	4*	Update Circular 1360.1, Automated Information Systems Security Policy, Section 6, to include a requirement that test plans be developed and approved for periodic testing of security controls in general support systems.
	5*	Ensure the information security staff develops network vulnerability test plans that meet the documentation requirements of the Office of Management and Budget Circular No. A-130 and National Institute of Standards and Technology guidance.
	7*	Formalize and document procedures where the oversight manager periodically reviews the accuracy of information recorded in the tracking system.

Report Number, Title, and Date	Significant Recommendation Number	Brief Summary of Planned Corrective Actions and Associated Monetary Amounts
Management Action In Process (continued)		
02-027 Computer Security Incident Response Team Activities August 28, 2002	9*	Update the circular, guide, and manuals requiring the Computer Security Incident Response Team to report to other FDIC security components at the conclusion of all investigations of computer security incidents.
	10*	Update Circular 1360.1, Automated Information Systems Security Policy, to include a requirement for establishing security program performance goals and measures.
02-035 Information Security Management of FDIC Contractors September 30, 2002	1	Develop additional policies and procedures for the consideration of information security in acquisition planning.
	2	Develop policies and procedures to ensure that the appropriate information security requirements are incorporated into information services contracts.
	3	More clearly define oversight manager roles and responsibilities for contractor security.
	4	Develop the capability of oversight managers to monitor security practices by providing adequate guidance and training on security oversight and security evaluation.
	6	Require oversight managers to inform the contractors of their roles and responsibilities for information security; and observe and document contractor security practices.
Litigation		
96-014 Superior Bank, F.S.B., Assistance Agreement, Case Number C-389c February 16, 1996	1, 4-16	Recover \$4,526,389 of assistance paid to Superior Bank.
	2, 3, 4, 6	Recover \$1,220,470 of assistance paid to Superior Bank.
98-026 Assistance Agreement Audit of Superior Bank, Case Number C-389c March 9, 1998	11	Compute the effect of understated Special Reserve Account for Payments in Lieu of Taxes and remit any amounts due to the FDIC.

*The OIG has not evaluated management's actions in response to OIG recommendations.

Table I.2: Audit Reports Issued by Subject Area

Number and Date	Audit Report Title	Questioned Costs		Funds Put To Better Use
		Total	Unsupported	
Supervision and Insurance				
03-004 November 6, 2002	OCC's and OTS's Responses to the OIG's February 2002 Follow-up Report on the FDIC's Use of Special Examination Authority and DOS's Efforts to Monitor Large Bank Insurance Risk			
03-006 November 18, 2002	DSC Procedures for Addressing Deviations from Business Plans by Newly Established Banks			
03-009 December 23, 2002	Examiner Assessment of High Loan-Growth Institutions			
03-008 January 3, 2003	Examiner Assessment of Commercial Real Estate Loans			
03-017 March 10, 2003	Material Loss Review of the Failure of the Connecticut Bank of Commerce, Stamford, Connecticut			
03-019 March 18, 2003	Division of Supervision and Consumer Protection's Examination Assessment of Subprime Lending			
03-018 March 21, 2003	FFIEC Call Report Modernization Cost Benefit Analysis			
03-021 March 26, 2003	FDIC Examiner Use of Work Performed by Independent Public Accountants			
EVAL-03-025 March 27, 2003	Division of Supervision and Consumer Protection's Examination of Transactions With Affiliates			
03-022 March 31, 2003	Division of Supervision and Consumer Protection's Reporting on Issues Related to Problem Banks			

Table I.2: Audit Reports Issued by Subject Area

Number and Date	Audit Report Title	Questioned Costs		Funds Put To Better Use
		Total	Unsupported	
Receivership and Legal Affairs				
EVAL-03-005 November 4, 2002	FDIC's Corporate Readiness Plan			
03-012 February 14, 2003	Controls Over the Use and Protection of Social Security Numbers by Federal Agencies			
03-027 March 31, 2003	Division of Resolutions and Receiverships' Controls Over Data Input to the Service Costing System			\$37,242
Information Assurance				
03-001 October 2, 2002	Integration of Information Security into the Capital Planning and Investment Control Process			
03-007 November 27, 2002	Phase II Network Operations Vulnerability Assessment			
03-016 March 5, 2003	New Financial Environment Project Control Framework			
Resource Management				
03-003 October 3, 2002	Controls Over Board Members' Travel			
03-013 January 31, 2003	FDIC Procurement Credit Card Program			
03-020 March 24, 2003	Travel, Relocation, and State Income Tax Withholding Policies and Procedures			
03-024 March 27, 2003	Internal Control Over Receivership Receipts			
03-026 March 28, 2003	Internal Control Over Receivables from Failed Insured Depository Institutions			

Table I.2: Audit Reports Issued by Subject Area

Number and Date	Audit Report Title	Questioned Costs		Funds Put To Better Use
		Total	Unsupported	
Post-award Contracts Audits				
03-010 December 24, 2002	Post-award Contract Review	\$ 11,308 [▲]		\$781,140
03-011 January 10, 2003	Post-award Contract Review	\$291,373 [▲]		
03-015 February 25, 2003	Post-award Contract Review	\$ 11,676 [■]		
EVAL-03-023 March 27, 2003	Post-award Contract Review			\$127,396
Preaward Reviews				
03-002 October 9, 2002	Preaward Contract Review			
03-014 February 5, 2003	Preaward Contract Review			
TOTALS FOR THE PERIOD		\$314,357		\$945,778

[▲]Management decision pending.

[■]Management response not due until April 25, 2003.

Table 1.3: Audit Reports Issued with Questioned Costs

	Number	Questioned Costs	
		Total	Unsupported
A. For which no management decision has been made by the commencement of the reporting period.	1	\$ 215,174	\$ 0
B. Which were issued during the reporting period.	3	314,357	0
Subtotals of A & B	4	529,531	0
C. For which a management decision was made during the reporting period.	1	215,174	0
(i) dollar value of disallowed costs.	1	25,484	0
(ii) dollar value of costs not disallowed.	1 [▼]	189,690	0
D. For which no management decision has been made by the end of the reporting period.	3*	314,357	0
Reports for which no management decision was made within 6 months of issuance.	0	\$ 0	\$ 0

▼ The one report included on the line for costs not disallowed is also included in the line for costs disallowed, since management did not agree with some of the questioned costs.

*Management response not due until April 25, 2003, for one report with questioned costs totaling \$11,676.

Table I.4: Audit Reports Issued with Recommendations for Better Use of Funds

	Number	Dollar Value
A. For which no management decision has been made by the commencement of the reporting period.	1	\$1,559,418
B. Which were issued during the reporting period.	3	945,778
Subtotals of A & B	4	2,505,196
C. For which a management decision was made during the reporting period.	3	1,724,056
(i) dollar value of recommendations that were agreed to by management.	3	1,617,160
- based on proposed management action.	3	1,617,160
- based on proposed legislative action.	0	0
(ii) dollar value of recommendations that were not agreed to by management.	1 [▲]	106,896
D. For which no management decision has been made by the end of the reporting period.	1	781,140
Reports for which no management decision was made within 6 months of issuance.	0	\$ 0

[▲]The one report included on the line for recommendations not agreed to by management is also included in the line for recommendations agreed to by management since management did not agree with some of the funds put to better use.

Table I.5: Status of OIG Recommendations Without Management Decisions

During this reporting period, there were no recommendations without management decisions.

Table I.6: Significant Revised Management Decisions

During this reporting period, there were no significant revised management decisions.

Table I.7: Significant Management Decisions with Which the OIG Disagreed

During this reporting period, there were no significant management decisions with which the OIG disagreed.

Table I.8: Instances Where Information Was Refused

During this reporting period, there were no instances where information was refused.

Abbreviations and Acronyms

ATM	Automated Teller Machine	FRB	Federal Reserve Board
BACU	Bank Account Control Unit	GAO	U.S. General Accounting Office
BIF	Bank Insurance Fund	GENESYS	General Examination System
CBA	cost benefit analysis	GISRA	Government Information Security Reform Act
CBC	Connecticut Bank of Commerce	HCSB	Hartford-Carlisle Savings Bank
CCP	Country Club Properties, LP	IFS	Institution for Savings
CFO	Chief Financial Officer	IG	Inspector General
COO	Chief Operating Officer	IPA	Independent Public Accountant
CPICP	Capital Planning and Investment Control Process	IRS	Internal Revenue Service
CRA	Community Reinvestment Act	IT	Information Technology
CRP	Corporate Readiness Plan	NFE	New Financial Environment
DIRM	Division of Information Resources Management	OCC	Office of the Comptroller of the Currency
DOA	Division of Administration	OI	Office of Investigations
DOF	Division of Finance	OICM	Office of Internal Control Management
DOS	Division of Supervision	OIG	Office of Inspector General
DRR	Division of Resolutions and Receiverships	OTS	Office of Thrift Supervision
DSC	Division of Supervision and Consumer Protection	PCIE	President's Council on Integrity and Efficiency
ECIE	Executive Council on Integrity and Efficiency	PDD	Presidential Decision Directive
EFC	Equity Funding Corporation	PwC	PricewaterhouseCoopers Consulting
FBI	Federal Bureau of Investigation	Results Act	Government Performance and Results Act
FDI Act	Federal Deposit Insurance Act	RTC	Resolution Trust Corporation
FDIC	Federal Deposit Insurance Corporation	SAIF	Savings Association Insurance Fund
FFIEC	Federal Financial Institutions Examination Council	SSN	Social Security Number
FISMA	Federal Information Security Management Act of 2002	UDA	unclaimed deposits amendments
		UFSB	Universal Federal Savings Bank

Congratulations to Award Recipients

Two Members of the OIG Staff Receive FDIC Awards

We are proud of two staff members from the Office of Inspector General's Office of Audits who received recognition at the Corporation's Annual Awards Ceremony on March 12, 2003.



Pictured left to right: G. Gianni, S. Smith, S. Beard, M. Lombardi, R. Rau.

Mike Lombardi was recognized as part of the Risk Management Examination Process Redesign 2 (MERIT) Team that received the Chairman's Excellence Award for Group/Team Contributions.



Pictured left to right: FDIC Chairman Powell, M. Galvin, G. Gianni.

Monte Galvin received the Nancy K. Rector Public Service Award for her dedicated involvement over the past 3 years with Habitat for Humanity.

Inspector General Receives Association of Government Accountants' Distinguished Federal Leadership Award

Inspector General Gianni received the Association of Government Accountants' (AGA) Distinguished Federal Leadership Award. This award formally recognizes elected or Presidentially appointed federal officials who exemplify and promote excellence in government management and have demonstrated outstanding leadership in enhancing sound financial management legislation, regulations, practices, policies, and systems. The AGA award acknowledged the Inspector General's 38-year federal career dedicated to promoting economy, efficiency, effectiveness, and integrity throughout government.



Inspector General receives AGA award from Bill Anderson, National President.

OIG Recognizes Staff



David H. Loewenstein

David retired after more than 13 years of dedicated service to the Federal Deposit Insurance Corporation and over 25 years of federal service. An FDIC Board Resolution signed by FDIC Chairman Donald E. Powell was presented to David in honor of his retirement. During the banking crisis, David worked to improve the operations of the Corporation, particularly in the area of receivership management for failed institutions. He played a key role in the OIG during and after the FDIC's merger with the Resolution Trust Corporation. His efforts in establishing a new function within the OIG enabled our office to more effectively meet its responsibility to interact with the Congress.

David's career also included service at the Federal Home Loan Bank Board OIG, where he focused management attention on significant issues and helped establish a highly effective OIG. Throughout his career he also worked unselfishly with charitable and social causes, including work on behalf of high-risk youth.



Naomi Pully

Naomi's 25-year government career included service at the FDIC, Department of the Treasury, Federal Mediation and Conciliation Service, Federal Home Loan Bank Board, and Office of Thrift Supervision. At the FDIC OIG, Naomi provided valuable administrative support to the Office of Audits. She participated actively in the International Association of Administrative Professionals and served as 1999-2000 President for the District of Columbia Chapter, a commitment that earned her the Distinguished Chapter President's Award.



Shelia Straughn

After more than 20 years of federal service, Shelia retired from the FDIC. Her career began at the U.S. Department of Housing and Urban Development and later included positions with the D.C.

Government Superior Court, the Department of Justice Immigration and Naturalization Service, and the FDIC. She provided valuable administrative support to the OIG, contributed greatly to programs for Administrative Professionals Week and related activities, and helped with the FDIC OIG Diversity Action Plan.



Sandra Harding

Sandra retired after more than 20 years of federal service. Her career included working in the Offices of Inspector General of the FDIC, Department of Defense, and Federal Home Loan Bank Board. As a Senior Audit Specialist, she was responsible for conducting audits of corporate programs in the supervision and compliance divisions of the FDIC. Her efforts resulted in recommendations to improve the efficiency and effectiveness of FDIC operations and help ensure the safety and soundness of the nation's banking system.



Josef Bartos

Josef retired after more than 11 years of federal service. He distinguished himself through his work in developing the OIG's major information systems. Other notable achievements included his efforts on the OIG's Y2K Readiness Project and assistance to OIG staff with their computer and information needs. Overall, Josef's keen analytical skills, database expertise, and extensive computer knowledge served to enhance OIG operations and effectiveness.



Gloria Hill

The OIG salutes Gloria Hill who was recalled to active duty in the Naval Reserve in early March 2003.

Inspector General Community Efforts Produce Results

The FDIC OIG is proud to be a part of the Inspector General community, whose efforts across the government during fiscal year 2002 produced impressive results, as highlighted in the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency's *A Progress Report to the President*. Thousands of audits, investigations, and other reviews offered recommendations to promote economy, efficiency, and effectiveness, as well as prevent and detect fraud, waste, and abuse in federal programs and operations. These results include:

- Potential savings of nearly \$72 billion.
- Nearly 10,700 successful criminal prosecutions.
- Suspensions or debarments of over 7,600 individuals or businesses.
- Almost 2,200 civil or personnel actions.
- More than 5,700 indictments and criminal informations.
- Over 234,000 complaints processed.
- More than 90 testimonies before the Congress.

These accomplishments reflect the work of over 11,000 men and women in 57 offices throughout the federal government.



For additional information about the IG community, visit www.ignet.gov

OIG Hotline



The Office of Inspector General (OIG) Hotline is a convenient mechanism that employees, contractors, and others can use to report instances of suspected fraud, waste, abuse, and mismanagement within the FDIC and its contractor operations. The OIG maintains a toll-free, nationwide Hotline (**1-800-964-FDIC**), electronic mail address (**IGHotline@FDIC.gov**), and postal mailing address. The Hotline is designed to make it easy for employees and contractors to join with the OIG in its efforts to prevent fraud, waste, abuse, and mismanagement that could threaten the success of FDIC programs or operations.

To learn more about the FDIC OIG and for complete copies of audit and evaluation reports discussed in this Semiannual Report, visit our homepage:
<http://www.fdic.gov/oig>



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